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Tokyo Applauds Budget Agreement

American voters in Peoria and elsewhere have not yet rendered their verdicts, but the new five-year, $490 billion deficit-reduction agreement is playing well in Tokyo. Unnamed Japanese officials at both the Bank of Japan and the Ministry of Finance -- not known to be enamored of the United States Congress -- praised that beleaguered American institution in addition to the Bush administration for working out the complicated, politically difficult accord.

Analysts on both sides of the Pacific believe that the Federal Reserve Board now may feel freer to ease monetary policy since it does not have to be quite so worried that doing so would set off inflation, the likely result absent the new agreement. Such a Fed move then would open the door for similar BOJ action should the dollar, as would be likely, drop even lower than current ranges in response to lower U.S. rates. In short, the budget agreement may have liberated the central banks in both the United States and Japan.

The Bank of Japan appears to take a dim view of this scenario because in public, at least, it does not agree that Japan's economy needs the boost that

U.S.-bound flights. Japanese negotiators also said that talks with European carriers may yield some additional evening slots. European airlines, which to date have served the Euro-Japanese market via Anchorage, Alaska, are interested in changing to a flight path that takes them over Siberia. If these talks proceed smoothly, the preferred takeoff time for European carriers would be in early morning; this, Japanese negotiators pointed out, also would make more evening slots available for east-bound UPS flights. However, since a trans-Siberian flight path requires Soviet Union permission, Tokyo could not guarantee that the European carriers would win these rights.

Washington rejected both of these options. According to American sources, UPS still would have no long-term guarantee that it could depart Tokyo at the times best-suited for U.S. deliveries. DOT also is concerned about how "temporary" slots for UPS would affect Tokyo's future award of landing rights to Delta and American.

Further formal discussions have yet to be scheduled, although U.S. officials maintain that there have been frequent informal communications between the two governments at the working level. Washington also evidently has encouraged UPS to consult on its own with Japanese officials in an effort to realize a breakthrough. But the prospects for a near-term resolution of this dispute appear fairly dim. Japanese negotiators reportedly have reminded their American counterparts that Tokyo would be more willing to accommodate the UPS request if Washington would issue JAL and NCA start-up rights for Chicago flights. U.S. negotiators, however, refuse to relinquish the leverage provided by withholding access to the lucrative Midwest market. The stalemate continues -- as has been the pattern in bilateral aviation negotiations for more than a decade.

Barbara Wanner

Japan Sets Plan To Stabilize Emissions Linked To Global Warming

Japan's plan for stabilizing by the year 2000 emissions of carbon dioxide and other gases associated with the potential warming of the earth's atmosphere might be considered lukewarm in Germany but radical by some in the Bush administration. While the stabilization plan falls short of the reductions laid out earlier this year by Bonn, its existence puts pressure on Washington, which so far has refused to come up with a policy addressing CO_2 emissions. Although the scientific world continues to assess the chance that a variety of gases could cause global warming sufficient to melt polar icecaps and cause massive temperature disruptions, Tokyo has adopted the view that a worst-case scenario of global warming would "pose a serious threat to the very foundation of human life on earth."

To offset that risk the cabinet October 23 adopted a target of stabilizing carbon dioxide emissions at 1990 levels by the year 2000 and keeping other so-called greenhouse gases, such as methane and nitrous oxide, at their current levels. The stabilization goal aims at both per capita emissions, estimated at about 2.4 to 2.5 tons for the average Japanese in 1988, and aggregate CO_2 discharges, figured by Japanese officials to be about 342 million tons in 1990. The speed at which emissions are increasing as a result of fossil fuel-burning and the disappearance of forests that absorb CO_2 can be seen in a comparison with 1988 figures put out by the Carbon Dioxide Information Analysis Center in Oak Ridge, Tennessee. That year Japan emitted 296.9 million net tons compared to a figure of 1,445.2 million net tons for the United States as a whole or 5.8 tons per capita (see Table for metric equivalents).

Carbon Dioxide Emissions in Japan, United States and World, 1968-88

(in millions of metric tons)

	Japan	United States	World
1968	154.0	1,081.0	3,596
1973	250.7	1,275.4	4,647
1978	260.2	1,300.9	5,082
1983	239.9	1,149.4	5,084
1984	264.3	1,187.5	5,260
1985	254.2	1,201.3	5,379
1986	248.9	1,204.5	5,561
1987	246.9	1,257.5	5,680
1988	269.8	1,310.2	5,893

Source: Carbon Dioxide Information Analysis and Research Program, Oak Ridge (Tenn.) National Laboratory

Pointing to Japan's past record of energy efficiency, business interests allied with the Ministry of International Trade and Industry and argued against responding too aggressively in restricting greenhouse gas emissions, lest the rules constrain economic development and Japan's slowly increasing standard of living (for example, more cars and appliances, including air conditioners). This group worried in particular about the economic impact on Japan if other industrialized nations, namely the United States, failed to enact similar measures. However, confidence in Japan's ability to develop technological breakthroughs that will conserve energy or recycle and reduce greenhouse gas emissions helped win acceptance of a stabilization program. The adopted 20-year plan is much stronger than the "New Earth 21" program previously recommended by MITI, which had called for first stabilizing emissions over a 50-year period and then reducing them in the next 50 years (see JEI Report No. 27B, July 13, 1990).

Pressure for an international agreement to reduce carbon dioxide emissions also added to Tokyo's decision, announced prior to sending delegates to a 10-day climate change conference in Geneva. That United Nations-sponsored conference, which began October 29, is expected to produce a framework for talks next February in Washington on a global warming accord. A draft prepared for that forum urged stabilization, but preferably reduction, of emissions by 2000. Among the countries that reportedly have agreed to reduce CO_2 emissions are Germany, Austria, Denmark, Australia and New Zealand. The European Community is said to be considering a freeze on current levels of emissions by 2000 or 2005. On this issue, wrote the authors of Japan's global warming program, ". . . it is essential for Japan to take the lead in global efforts through international cooperation by making use of its advanced technology and ample experience in the conservation of the environment."

Program goals call for:

- Reduction of emissions from all transportation equipment -- cars and trucks as well as trains, ships and airplanes -- through improved fuel efficiency, either by switching to hybrid fuels, redesigning engines and/or creating lighter-weight frames. In this area motor vehicle exporters have an incentive: meeting new emissions standards adopted in the Clean Air Act just passed by Congress. Japanese makers worry, though, that they will have to break new ground to achieve the uniform tailpipe emissions reductions set by Congress. They also note that equipment to trap emissions currently adds weight, thus detracting from fuel efficiency at a time when both Tokyo and Washington are encouraging better gas mileage. (Tokyo's plan reportedly sets a fuel economy goal of about 31.3 miles per gallon in 2010, or 15 percent more than the 27.2 mpg average in 1988, still far less than the 40 mpg considered but rejected by Congress this year.)

- Promotion of cogeneration systems and use of heat now wasted in such areas as subways and sewage plants.

- Development of nuclear energy, which emits no carbon dioxide, "subject to the assurance of safety." Also supported are hydroelectric, natural gas and geothermal power plants. The use of oil as a fuel, however, is expected to drop from 57.9 percent of the nation's energy consumption in FY 1989 to 51.3 percent in FY 2000 and 45.3 percent in FY 2010, according to a separate forecast from MITI. The ministry's advisory group on atomic energy has urged construction of an additional 40 nuclear power plants in the next 20 years on top of the 39 now in operation.

- Reduction of peak-hour energy demand through the use of central controls.

- Promotion of mass passenger transportation as well as increased attention to new designs (of intersections as well as expressways) that improve transportation flows.

- Promotion of bulk freight transportation systems, specifically railways and ships, with improved terminals and information systems to increase efficiencies. Already the Tokyo metropolitan government has announced that it will limit truck traffic on city streets on Wednesdays between November and January. The goal is to reduce nitrogen oxide emissions by 30 percent during the winter months when weather conditions trap pollution.

- Promotion of alternative sources of energy and energy-efficient machinery in manufacturing as well as in agriculture, forestry and fisheries.

- Cutbacks in excessive packaging, the number of vending machines and unsolicited direct mailings as well as increased recycling and use of recycled materials.

- Reduction of working hours and consideration of daylight savings time to reduce work-related energy consumption.

- Adoption of insulation and energy-saving measures in construction, including passive solar systems and the use of greenery to cut the "heat-island phenomena in urban areas."

Beyond these targets to control emissions of greenhouse gases, the cabinet-approved plan urges improvements in forestry techniques aimed at sustainable management, not only domestically but through cooperative efforts internationally. The proposal recommends formulation of an international charter to maintain forests but acknowledged the sovereignty of nations with tropical forests. Since Japanese companies have been much criticized over their logging practices in Southeast Asia (see JEI Report No. 10A, March 9, 1990), this part of the plan would appear to signal more government involvement in conservation efforts.

The plan also calls for increased research into technologies that control greenhouse gas emissions or provide ways to prevent desertification. The report stresses the importance of technology transfers so that developing nations' energy usage does not destroy the inroads made by Japan and other industrialized nations against the proliferation of greenhouse gases. And, finally, the outline backs studies into how to cope with global warming, for example by developing seeds that can adapt to warmer climates or technologies that counteract rising sea levels.

Annual reports to the Council of Ministers for Global Environment Conservation, which is headed by the prime minister and consists of 20 ministery and agency heads, will track progress. While the measure has its detractors at home and abroad and relies greatly on administrative guidance, international efforts to reduce carbon dioxide emissions and worries over oil supplies in light of the Persian Gulf crisis may be sufficient to move Japan toward even greater energy efficiencies in the upcoming years.

Pat Murdo

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A Two-Part Report: A and B

NO. 43A November 9, 1990

JAPAN'S OVERSEAS TECHNICAL ASSISTANCE PROGRAM

Summary

Now that Japan is the world's largest foreign aid donor, the initial focus on yen loans and grants is evolving to address technical assistance, which includes human resource development. Developing countries consider trained personnel essential to continued economic progress. Therefore, expectations have grown for Japan to offer more technical assistance through sending experts to countries that receive aid and accepting trainees from them. Since much-sought-after industrial technology and management know-how are gained primarily from the private sector, the Japanese business community, as well as the government, has a large role to play to facilitate Japan's extension of technical assistance. More effective and collaborative networks between the government and the private sector are critical if Japan is to cope with the expanding call for human resource development in Third World countries.

A More Influential Aid Donor

Japan's outlay of Y1.2 trillion-plus ($9 billion at the 1989 average exchange rate of Y137.96=$1.00) made it the world's largest donor of official development assistance in 1989. This number-one ranking among the 18 members of the Development Assistance Committee of the Organization for Economic Cooperation and Development came after strong second-place showings in the previous two years (see JEI Report No. 26B, July 6, 1990). From the start of its economic aid program to developing countries in 1955, Tokyo has considered foreign aid as one way it could contribute to an improved global society. In 1988 this theme became one of then Prime Minister Noboru Takeshita's three pillars in

Japan's more internationalist outlook: expanded economic cooperation, support of international peace initiatives and increased cultural exchanges.

Growing expectations from other industrialized nations and from developing countries for Japan to share its increased wealth prompted the government to increase its goals for ODA outlays continually in the 1980s. For example, the target for foreign aid expenditures between 1988 and 1992 is to provide over $50 billion in economic assistance, more than double the expenditures of the 1983-87 period. As shown in Table 1, Japan's foreign aid has expanded nearly 20-fold since 1970. Part of this rapid increase can be attributed to the appreciation of the yen between 1985 and late 1988 since aid figures are calculated by the OECD on the basis of net disbursements in dollars. But, even when viewed in yen, Tokyo has been generous.

Table 1: Allocation of Japan's Official Development Assistance

(in millions of dollars, disbursement basis)

Year	1970	1975	1980	1985	1988	1989
Bilateral Aid	$372	$850	$1,961	$2,557	$6,422	$6,779
Loans	250	649	1,308	1,372	3,514	3,741
Grants	100	115	375	636	1,483	1,556
Technical Assistance*	22	87	278	549	1,425	1,481
Technical Assistance Share	5.9%	10.2%	14.2%	21.5%	22.2%	21.8%
Multilateral Aid	87	297	1,343	1,240	2,712	2,186
Total ODA	458	1,148	3,304	3,797	9,134	8,965
Share of Technical Assistance in Total ODA	4.8%	7.6%	8.4%	14.5%	15.6%	16.5%

*Administrative costs and subsidies to nongovernmental organizations are included in the technical assistance figures. If they are excluded, technical assistance in 1988 and 1989 amounted to $1,093 million and $1,137 million, respectively.

Source: Ministry of Foreign Affairs, Wagakuni no Seifu Kaihatsu Enjo, 1990 (Japan's Official Development Assistance, 1990 Annual Report).

Throughout the 1980s foreign aid received priority in the general account budget even when other budget categories faced a bare-bones ceiling. Although the economic assistance funded by the general account budget is only a portion of Japan's net ODA disbursements (the rest comes from the Fiscal Investment and Loan Program and other sources), the budget perspective shows the upward trend in ODA allocations. The initial FY 1990 general account foreign aid budget, for example, amounted to Y817 billion ($6.1 billion at Y135=$1.00),

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more than double that allocated initially in FY 1981. The doubling of funds for ODA during this period exceeded the increases for all other budget categories, such as defense (up 73 percent), social security (a 34 percent gain), education (up 7 percent) and public works (a 7 percent decline).

Japan's Technical Assistance Outlook

Rather than concentrating on simply increasing foreign aid expenditures, the Japanese government also has worked to improve the quality of its overseas assistance by expanding grants and technical assistance. Table 1 breaks down Japan's aid disbursements into its major components. Financial assistance, especially in the form of loans, makes up the backbone of the program, although its share has dropped from about 70 percent in the 1970s to slightly more than half today. Both grants and technical cooperation have increased steadily. While developing countries appreciate the goods and infrastructure that loans and grants can help buy, technical assistance is becoming increasingly important to enable recipient countries to make the most out of their new materials and structures.

Broadly defined, technical assistance includes training citizens from recipient countries in Japan and dispatching Japanese experts in various areas like industrial technology and management. In other words, the term can be defined as assistance through the medium of men and women. As is indicated in Table 1, Japan boosted disbursements of technical cooperation from $22 million in 1970, equivalent to 4.8 percent of total bilateral and multilateral outlays, to $1.5 billion, or 16.5 percent of total ODA in 1989. The numbers include indirect administrative costs, such as expenditures for Japanese management staff, according to the Japanese government's definition of technical assistance. Excluding those costs, disbursements in 1989 would have been $1.1 billion, or 12.7 percent of total ODA.

In spite of increased funding for technical assistance in recent years, Japan's outlays still are small by international standards (see Table 2). The OECD's Development Assistance Committee does not count administrative costs in the technical assistance disbursement figures for its 18 member countries; thus, Japan's spending for technical cooperation was calculated as just under $1.1 billion in 1988. This amount was smaller than either that of France, the United States or West Germany, although Japan ranked as the second-largest ODA provider that year. Moreover, the ratio of Japan's technical assistance to total ODA -- 12 percent -- was one of the smallest among DAC member countries, which averaged 21.3 percent that year. In terms of helping developing nations with people power and not just money, Japan ranked 14th on the basis of technical assistance to total ODA in 1988.

Most of the technical cooperation that Japan funds falls into the categories of training either at home or through experts sent abroad. But the heading covers every kind of assistance other than grants and loans. Table 3 breaks down Japan's technical cooperation expenditures by purpose. Receiving foreign students and trainees from developing countries and sending experts to these countries accounted for 60.5 percent of 1988's spending. Not only does technical staff often accompany equipment purchased by grants, but they often may bring equipment provided under their training funds. For example, Japanese medical personnel often bring medical equipment to instruct local staff on how to use it. Among the other types of technical aid provided by Japan are cooperation in research and development, which includes funding for joint academic

Table 2: Comparision of Technical Assistance Provided by Members of Development Assistance Committee, 1988

(in millions of dollars)

Country	Total ODA (A)	Bilateral Aid (B)	Technical Assistance (C)	Share C/A	Share C/B
United States	$10,141	$6,765	$2,127	21.0%	31.4%
Japan	9,134	6,422	1,093	12.0	17.0
France	6,865	5,601	2,422	35.3	43.2
West Germany	4,731	3,172	1,594	33.7	50.3
Italy	3,183	2,408	286	9.0	11.9
United Kingdom	2,645	1,430	642	24.3	44.9
Canada	2,342	1,579	403	17.2	25.5
Netherlands	2,231	1,552	631	28.3	40.7
Sweden	1,529	1,054	207	13.5	19.6
Australia	1,101	622	203	18.4	32.6
Norway	985	572	86	8.7	15.0
Denmark	922	478	95	10.3	19.9
Switzerland	617	445	103	16.7	23.1
Finland	608	380	25	4.1	6.6
Belgium	597	423	176	29.5	41.6
Austria	302	163	68	22.5	41.7
New Zealand	105	93	49	46.7	52.7
Ireland	57	22	13	22.8	59.1
DAC Total	48,094	33,180	10,222	21.3	30.8

Note: DAC data exclude administrative costs and subsidies to nongovernmental organizations from technical assistance.

Source: Organization for Economic Cooperation and Development, Development Assistance Committee, Development Co-Operation: 1989 Report.

research projects between public institutes and/or universities in Japan and the recipient countries. International conferences on economic cooperation, construction of refugee centers in Japan and fact-finding missions on development projects in Third World countries are covered by the other categories shown in Table 3.

Table 4 shows the areas addressed by technical cooperation, such as basic human needs, economic infrastructure, manufacturing and services. Not only have requests for aid increased in recent years but they have grown more diverse. Since the Japanese government's manpower pool is inadequate to respond to the many and varied requests Tokyo receives, it has sought the cooperation of professionals in the private sector, especially from the manufacturing and the service industries, which are asked to host trainees in their factories or companies as well as to send technicians to government-run training programs as short-term instructors.

Government's Involvement in Technical Cooperation

A broad cross-section of government organizations has responded to Third World requests for technical assistance. In the central government alone 17

Table 3: Japan's Technical Assistance*

(in millions of dollars, disbursement basis)

	1985	1988	Percent Change
Receiving Students and Trainees	$118	$339	187.3%
Students	36	138	283.3
Trainees	83	202	143.4
Sending Personnel	216	483	123.6
Japan Overseas Cooperation Volunteers	23	51	121.7
Other Experts	193	432	123.8
Providing Equipment	54	130	140.7
Cooperation in Research and Development	7	12	71.4
Other	153	394	157.5
Total	549	1,359	147.5

*Administrative costs are included in the figures but subsidies to nongovernmental organizations are excluded.

Source: Ministry of International Trade and Industry, Keizai Kyoryoku no Genjo to Mondaiten, 1989 (White Paper on Economic Cooperation).

ministries and agencies are involved in technical cooperation (see Table 5). Among those chiefly in charge of receiving trainees and sending experts are the Ministries of Foreign Affairs, International Trade and Industry, and Labor. These three ministries accounted for 84.5 percent of the funds earmarked in the FY 1990 general account budget for technical cooperation. The other ministries and agencies involved in Japan's overseas technical assistance program tend to have various small, specific projects, such as scholarships for foreign students, international conferences on economic cooperation and exchanges of scholars and researchers for joint research projects. Thus, Tokyo's major efforts in the technical assistance field fall into the two principal areas of sending experts and receiving trainees; the government is the leading actor in both situations but relies heavily on the private sector.

Sending Experts - The Japan International Cooperation Agency, a government organization funded by the Foreign Ministry, and the Japan Overseas Development Corp., a semipublic organization underwritten by MITI, are the two major organizations in charge of sending experts to developing countries. While JICA dispatches primarily Japanese public servants to work with host countries' public organizations at the request of a developing country government, JODC sends specialists from Japan's private sector to companies in a host country after approving a request from a business organization or individual firm in the recipient country.

JICA's experts are divided broadly into two types. The first category includes those with professional knowledge in a specific field. Since JICA receives various kinds of requests, the organization asks public research

Table 4: Distribution of Japan's Technical Assistance, 1989

(in millions of dollars, commitment basis)

Category	Amount	Share
Basic Human Needs	$803	51.0%
Social Infrastructure and Services	601	38.2
Education and Vocational Training	345	21.9
Health	73	4.6
Water Supplies and Sanitation	29	1.8
Population Programs	7	0.4
Public Administration	7	0.4
Development Planning	43	2.7
Other	97	6.2
Agriculture	202	12.8
Economic Infrastructure	153	9.7
Transportation	68	4.3
Communications	38	2.4
River Development	18	1.1
Energy	25	1.6
Other	5	0.3
Industry, Mining and Construction	165	10.5
Trade, Banking and Tourism	21	1.3
Multisector	88	5.6
Administrative Costs	269	17.1
Unspecified	75	4.8
Total	1,575	100.0

Source: Ministry of Foreign Affairs, Wagakuni no Seifu Kaihatsu Enjo, 1990 (Ja-an's Official Development Assistance, 1990 Annual Report).

institutes, universities and even companies to provide qualified personnel on a short-term basis to JICA to respond to the requests. The second category draws on volunteers under age 39 who are interested in helping the social and/or economic development of Third World countries. These Japan Overseas Cooperation Volunteers do not always have to have sophisticated skills but are required to be healthy enough to live in outposts with few amenities. In the current fiscal year 2,512 experts and 854 volunteers have been given assignments overseas (see Table 6). These numbers are four times those of FY 1974 when JICA was established. By adding people sent in previous years who are still in the host countries, JICA presently can count 4,005 experts and 1,789 volunteers providing technical assistance to developing countries. JICA gives experts and volunteers training in English and/or in the host country's language and an introduction to the country's social and economic situation. It also offers some training in teaching methods where appropriate.

Table 5: Budgeted Technical Assistance by Ministry or Agency, FY 1990

(in millions of yen, general account budget)

Organization	Amount	Examples of Programs Funded
Ministry of Foreign Affairs	Y164,830	Japan International Cooperation Agency (training, Japan Overseas Cooperation Volunteers, fact-finding missions)
Ministry of Education	27,016	Scholarships for foreign students; academic exchanges
Ministry of International Trade and Industry	25,306	Association for Overseas Technical Scholarship (training); Japan Overseas Development Cooperation Association (experts)
Ministry of Agriculture	3,893	Promotion of food production and fishing; forest preservation
Management and Coordination Agency	1,434	Statistical assistance; international youth exchanges
Ministry of Labor	1,423	Japan Vocational Ability Development Association (training); Overseas Vocational Training Association (experts)
Ministry of Health and Welfare	597	Health and sanitation
Ministry of Justice	461	Refugee assistance; international crime prevention
Science and Technology Agency	455	R&D assistance in nuclear energy and environment
Ministry of Construction	384	R&D in overseas construction and sewage disposal
Ministry of Transportation	361	Transportation technology
Environment Agency	178	Global environmental problems
Ministry of Finance	157	Meetings with international financial organizations
Ministry of Posts and Telecommunications	116	Basic research in international telecommunications
Economic Planning Agency	111	Seminars on international cooperation
Police Agency	85	Seminars on organized crime in Asia; antidrug programs
Ministry of Home Affairs	12	Training of local government officials in developing countries
Total	226,819	

Source: Survey by Keidanren (Japan Federation of Economic Organizations)

Table 6: Expansion of JICA's Activities

	FY 1974	FY 1990	Percent Change
Budget (in billions of yen)	Y27.2	Y125.0	359.6%
Number of Trainees	2,169	6,388*	194.5
Number of Japanese Overseas Cooperation Volunteers	208	854*	310.6
Number of Other Experts	513	2,512* (1989)	389.7

*New appointees only. Current figures, including those who continue to stay in their positions, are as follows:

7,324 trainees as of FY 1990
1,789 JOCVs as of FY 1990
4,005 experts as of FY 1989

Source: Ministry of Foreign Affairs, Wagakuni no Seifu Kaihatsu Enjo, 1990 (Japan's Official Development Assistance, 1990 Annual Report).

Table 7 illustrates the geographical distribution of experts and volunteers in FY 1988. The majority of JICA's experts (55 percent) worked in East and Southeast Asia; 18 percent were in Latin America. The distribution of JICA personnel generally corresponds with the geographical allocation of Japan's bilateral aid (shown in Table 8). Many of JICA's volunteers, however, work in Africa, Latin America, Oceania and South Asia; requests from these areas generally are related to basic human needs, such as public health, primary education and agriculture.

Table 7: Number of Experts in Japan's Major Technical Assistance Organizations and Areas Served, FY 1988

	JICA		JOCV		JODC	
	Number	Share	Number	Share	Number	Share
East and Southeast Asia	1,357	55.5%	126	16.0%	143	74.5%
South Asia	206	8.4	94	11.9	13	6.8
Middle East	65	2.7	67	8.5	24	12.5
North Africa	76	3.1			0	0.0
Subsaharan Africa	192	7.9	235	30.0	0	0.0
Latin America	445	18.2	165	21.0	12	6.3
Oceania	29	1.2	89	11.3	0	0.0
Europe	14	0.6	0	0.0	0	0.0
Other	60	2.5	11	1.4	0	0.0
Total	2,444	100.0	787	100.0	192	100.0

Source: Ministry of Foreign Affairs, Wagakuni no Seifu Kaihatsu Enjo, 1990 (Japan's Official Development Assistance, 1990 Annual Report).

Table 8: Geographical Distribution of Japan's Bilateral ODA, 1989

(in millions of dollars, disbursement basis)

	Value	Share
Northeast Asia	$919	13.6%
Southeast Asia	2,226	32.8
Southwest Asia	1,091	16.1
Middle East	368	5.4
Africa	1,040	15.3
Latin America	563	8.3
Oceania	98	1.4
Europe	11	0.2
Unclassified	461	6.8
Total	6,779	100.0

Source: Ministry of Foreign Affairs, Wagakuni no Seifu Kaihatsu Enjo, 1990 (Japan's Official Development Assistance, 1990 Annual Report).

The much smaller Japan Overseas Development Corp. program enlisted 192 experts in FY 1988 and sent the majority (74.5 percent) to East and Southeast Asia, where Japanese investment activity is strong. JODC responds to requests from a host country's private sector. Armed with a request for a certain type of job and a specific time period, JODC asks Japanese employers whether they can afford to send employees to work in the country that has requested such aid. After JODC finds appropriate experts, it pays three-quarters of the total cost, including air fare, accommodations and salary; the host company covers the rest. A majority of JODC's activity is funded by MITI.

JODC revised its program somewhat in 1987. While the organization traditionally has dispatched experts based on requests from the private sector in developing countries, the program change allows JODC to address supplying Japanese companies' preferences as well. Japanese businesses that, independently of government, intend to send their experts to a certain company in a developing country can ask JODC to subsidize a part of the total cost on the condition that the host company is not affiliated with the Japanese firm that is providing the personnel.

JODC has dispatched more than 1,500 experts overseas since it was established in 1970. To facilitate sending personnel JODC has encouraged Japanese companies to register their eligible experts as candidates before actual requests come from developing countries. As of 1988 almost 800 technicians were registered. JODC provides initial training, for example in language, for the candidates.

Receiving Trainees - JICA also runs programs to train personnel sent by developing country governments. These trainees include public servants, researchers in public institutions and managers or engineers in state-owned corporations. After JICA provides orientation in the Japanese language and a basic introduction to the Japanese economy and culture, the trainees go to various public institutions, local governments and companies in Japan to improve their knowledge in specific areas. The number of trainees expected to be accepted in FY 1990 is 6,388, nearly three times as many as in FY 1974. Table 9 illustrates the geographical distribution of trainees hosted by JICA in FY 1988. Similar to the dispatch of JICA experts, almost two-thirds of the trainees that year came from East Asia, Southeast Asia and Latin America.

Another program that provides training in Japan is the Association of Overseas Technical Scholarship, established in 1959 to facilitate private-sector participation in technical assistance. While JICA accepts trainees in the public sector following a request from a developing country, MITI-funded AOTS sponsors managers and engineers of private companies sent from developing countries at the request of Japan's private sector. Host companies first recommend trainees who can benefit from a stay in Japan to improve their technical skills. If the application is accepted under the AOTS program, the organization provides the trainees with basic guidance, including Japanese language and management practices, before they go to receive practical training in Japanese companies. AOTS usually pays three-quarters of the total training costs, including both orientation and on-the-job training. Japanese host companies pay the rest. In FY 1988 AOTS received over 2,700 trainees, bringing the total number accepted by the organization over the past 25 years to 37,700. As is shown in Table 9, most of the trainees come from East Asia and Southeast Asia.

Table 9: Number of Trainees Hosted by Main Technical Cooperation Organizations and Areas Served, FY 1988

	JICA		AOTS	
	Number	Share	Number	Share
East and Southeast Asia	3,313	48.5%	2,067	75.4%
South Asia	618	9.0	229	8.4
Middle East	274	4.1	81	3.0
North Africa	209	3.1	26	0.9
Subsaharan Africa	685	10.0	80	2.9
Latin America	1,369	20.0	232	8.5
Oceania	258	3.8	16	0.6
Europe	104	1.5	9	0.3
Other	3	0.0	0	0.0
Total	6,833	100.0	2,740	100.0

Source: Ministry of International Trade and Industry, Keizai Kyoryoku no Genjo to Mondaiten, 1989 (White Paper on Economic Cooperation).

Recently the Japanese government has accepted trainees under specialized programs with several developing countries. For example, an arrangement with the Mexican government in effect since 1971 calls for the countries to exchange 50 to 100 engineers, public servants, scholars and students every year. Under an agreement with Malaysia the Japanese government has received 200 to 300 technicians every year since 1982. A similar program has applied to South Korean technicians since 1984. Following Prime Minister Toshiki Kaifu's visit to Eastern Europe in January of this year, hundreds of Polish and Hungarian technicians have gone to Japan to learn industrial technology and management. Other Eastern European countries will participate in the project from 1991.

Trainees in these country-specific projects come from both the public and the private sectors based on a recommendation from their home government. JICA takes the trainees from the public sector, while AOTS is in charge of those from the private sector. Applicants follow the same orientation and practical training paths that other JICA and AOTS trainees do. To make the most of these opportunities, JICA, AOTS, government organizations and concerned business organizations, such as Keidanren (Japan Federation of Economic Organizations) and the Japan Chamber of Commerce and Industry, have organized special task forces to backstop each country-specific agreement.

The Ministry of Labor, which so far mainly has provided vocational training for Japanese instructors going overseas, is expanding its activities to offer technical assistance to workers from developing countries. Vocational training centers operated by MOL's Japan Vocational Ability Development Association were opened to foreign workers in February 1990, when the ministry invited about 200 workers between the ages of 18 and 25 from Thailand, Malaysia and Indonesia to come to Japan. These workers will spend two years at Japanese vocational training centers and factories. Each of the trainees is recommended by the labor-related ministry of his or her home government. Whereas most of the trainees received by AOTS are managers and engineers with more than 10 years of working experience, many high school graduates and unskilled employees participate in the MOL program. The Labor Ministry expects to increase the number of trainees and to broaden the number of eligible countries if the initial program works well.

Mixed Government Attitudes Toward Foreign Trainees

Tokyo's program of aiding developing countries through technical assistance intersects with government efforts to control the number of illegal foreign workers in the country (see JEI Report No. 23A, June 15, 1990). While those accepted for training under technical assistance programs are in Japan legally, people concerned about the influx of foreign workers worry that trainees will not necessarily return home at the end of their program. Thus, suggestions from aid officials and developing countries to expand the domestic portion of technical cooperation are undergoing serious review by the government as well as the ruling Liberal Democratic Party and the opposition parties.

Except for immigration records, there is no official survey of the number of foreign trainees in Japan or where they are from. Immigration data show almost 30,000 foreigners entered Japan in 1989 on a training visa. Approximately 22,700 of these came from Asia, particularly Thailand, South Korea, the Philippines and China. This figure includes government-sponsored trainees, like those hosted by JICA and AOTS, plus those sponsored by businesses. Some of the trainees' visas reportedly were arranged by organizations illegally, which then sent the "trainees" to work in companies.

Concerned about the problem of distinguishing between legal and illegal trainees, the Ministries of Foreign Affairs, International Trade and Industry, Labor and Justice are studying the possibility of establishing an organization in collaboration with the business sector to monitor the state of foreign workers' training in Japan. The collaborative venture also would offer guidance to companies that accept trainees and provide to the trainees medical insurance coverage, vocational training in public facilities, advice on living in Japan and follow-up after the trainees return home.

The Foreign Ministry and MITI, which want an increase in government-sponsored trainees to demonstrate Japan's international cooperation through such human exchange, nevertheless are concerned that the proposed organization might intervene in the operations of JICA and AOTS; they have yet to take a clear stance. According to a late August 1990 article in Nihon Keizai Shimbun, the proposed monitoring organization is a by-product of a dispute between the Labor Ministry, which endorses accepting foreign workers, and the Justice Ministry, which has reservations about an increase in the number of foreign workers in Japan (see JEI Report No. 39B, October 13, 1989). Labor is pushing a plan allowing people who train in Japanese companies to stay in the country after the completion of their programs and work legally with the status of a skilled foreign laborer (see JEI Report No. 23A, June 15, 1990). MOL says such a plan would benefit both foreign trainees who want to work in Japan and some Japanese companies, especially small and midsized enterprises now suffering from a shortage of labor. Under MOL's interpretation those foreigners who have trained in a Japanese company no longer would be regarded as unskilled (illegal foreign) laborers since they have learned specific skills. The Ministry of Justice reportedly opposes MOL's idea since such an interpretation would provide a loophole in current immigration regulations, which prohibit visas for unskilled foreign workers. Concerns about the unregulated admission of foreign workers to Japan has an obvious impact on Tokyo's plan to extend its technical expertise by receiving trainees from developing countries.

Private Sector's Involvement in Technical Assistance

The private sector contributes to overseas technical assistance in several ways, officially and unofficially:

- By training personnel directly associated with its foreign business operations;

- By sending experts to government agencies, for example to JICA, on a temporary basis;

- By accepting trainees from foreign companies that are indirectly connected to their foreign activities, as suppliers or customers, for example; and

- By providing in-house training for employees sent by foreign governments or businesses under the auspices of a Japanese government program.

Background - The steep appreciation of the yen between 1985 and late 1988 led many Japanese exporters to shift output to factories overseas. While much of the money for offshore production facilities has gone into the United States and Europe, Ministry of Finance figures through March 1990 indicate that 23.6 percent of Japan's foreign manufacturing stake was in Asia, particularly in the newly industrialized economies of South Korea, Taiwan, Hong Kong and Singapore; another 8.5 percent was in Latin America (see JEI Report No. 23B, June 15, 1990). While location decisions depend on many factors, the cost of labor, which includes the amount of on-the-job training necessary, is high on the list (see JEI Report No. 22A, June 9, 1989).

Japanese employers traditionally have placed a high priority on human resource development and continuously provide in-house training to improve the quality of their labor force. A similar corporate strategy has been adopted for their overseas affiliates. The parent company typically sends managers and engineers to the subsidiary in a developing country to provide skills to local production workers and know-how to managerial employees. The parent also often invites local managers and engineers to Japan to provide further training. Not a few corporations are making concrete efforts in the technical assistance field, such as setting up their own vocational training facilities both in Japan and abroad and hiring full-time instructors. Although this kind of activity is not counted as official development assistance, it makes up an important part of Japan's overseas technical assistance program.

Increasing Third World requests for technical assistance at both the public and the private levels have raised expectations that Japan's business community will become more involved in technical assistance, sending experts to and taking trainees from not only their overseas affiliates but from other organizations as well. Since they already are busy training employees from their foreign subsidiaries and joint ventures, however, Japanese manufacturers and other companies say they do not have the resources to train workers not related to their business. Without incentives the private sector is unlikely to become involved more heavily in noncommercial activities that would expand Japan's ability to offer technical cooperation to developing countries. Even though Tokyo has projected increases in its foreign aid program, the weakness in the private-sector link may retard effective dispersion of the technical assistance component.

Motivations for the Private Sector - A major restriction in providing increased technical assistance is a shortage of qualified instructors. Not only are instructors required to have technical knowledge and foreign language ability but they also are expected to be able to transcend cultural barriers; this takes time. Businesses, in particular, hesitate to assign valuable personnel to JICA or other technical assistance programs even if the government compensates the company by paying salaries. What is needed, individual firms and business organizations have told the government, is for the sponsoring ministry also to cover business losses caused by the absence of company experts.

In-house training also poses problems, according to companies that have accepted government-sponsored trainees. Insufficient government funds and a shortage of qualified instructors make it difficult to meet rapidly growing requests from developing countries, they say. A survey by Keidanren underscored the discrepancy between what it costs a company to provide in training and what the government reimburses. The survey showed that the cost to the company of training one JICA-approved worker totaled more than Y1 million ($7,407) a month, yet only about one-tenth of this amount was covered by the government. In particular the government does not fully reimburse instructors' fees since these company employees already are receiving a salary. However, as instructors they typically also receive a stipend, which the government does not cover. This example would seem to indicate that the cost-sharing formula will have to be revised before more companies participate in government-sponsored trainee programs.

Japanese companies, however, do gain some benefit from their training contributions. For trainees sent by suppliers, customers or other company-selected organizations, the trained individuals presumably will contribute to the Japanese company's long-run welfare upon their return to their home base. Moreover, to the degree that trainees participating in on-the-job training contribute to the output of the Japanese company, the training cannot be counted as a pure cost. Therefore, any cost-sharing formula would have to tread the line between subsidizing private activities and providing sufficient incentive for the private-sector to participate in a broad national program.

The problem of an insufficient number of qualified instructors in both the government and the private sector goes beyond the issue of financial compensation. Given the way career advancement generally works in Japan, an excursion outside the regular path to success can be considered a dead end and not just a detour. It has been reported that people who accept temporary overseas assignments as JICA specialists or Japan Overseas Cooperation Volunteers return to find that they have a harder time being promoted than their colleagues. While the increased number of employees working abroad for Japan's multinational corporations may have begun to alter the traditional view of career paths and made service abroad an important asset, this hurdle most likely will continue for most employees who take a temporary leave of absence to work for JICA or JOCV.

One way the government is considering making overseas service more attractive to Japanese companies is by broadening the areas of study and the opportunities provided to workers who sign up as instructors from the private sector. The Labor Ministry has set up the Overseas Vocational Training Association to provide skilled Japanese workers with special training to become instructors overseas. Those who have received training from the association can work overseas not only as JICA experts but for their employer as well. The government, in cooperation with Keidanren, also established this year a new type of advanced training and research organization, the Foundation for Advanced Studies on International Development, to foster the progress of personnel who are well-versed in international development affairs in general and have expertise in human resources development. The organization admits applicants from both the public and the private sectors.

Business Community's Initiative - Despite the concerns of some corporate executives, several organizations have taken the initiative to help provide technical assistance to developing countries. These moves not only reflect the increase in requests for Japanese companies to accept government-sponsored trainees or to send experts to Third World countries but also the thinking in the private sector that it might be better to respond positively so that the business community will be a full partner in a well-rounded, organized program rather than responding to sometimes haphazard requests.

The business community of western Japan (Kansai) worked with local governments to establish the Pacific Human Exchange Center this year. The center assists trainees from the Asian Pacific region by lining up potential company sponsors in the Kansai area. The organization collaborates with the local branch offices of JICA and AOTS and makes a list of companies that have agreed to host trainees. Nikkeiren (Japan Federation of Employers' Associations) and the Japan Productivity Center also launched several management training programs for workers sent from developing countries and some of the newly democratizing socialist countries.

In a position paper unveiled in April on promoting the development of human resources in Third World countries Keidanren urged Japan to improve the networks between public agencies and the private sector to facilitate sending experts and receiving trainees. Specifically, Keidanren suggested that the ministries and the agencies involved in overseas technical cooperation maintain closer liaison with each other to improve the coordination of policymaking. It noted, for example, that while several government white papers or annual reports discuss technical cooperation, no one report covers the activities of all the organizations working in the technical assistance field. More concretely, the business organization advocated that ministries and agencies work together to produce a brochure in Japanese and English on the form, current state and procedures associated with Japan's technical assistance program.

Other mechanisms for the private provision of training appear to be limited by the nature of Japanese career patterns. For example, the creation of specialized schools under contract to the Japanese government and oriented toward training foreign workers is thwarted by the difficulty of attracting qualified teachers from their corporate employers. The same barriers would impede the formation of government-managed training institutes. In the short-run, at least, the private sector's monopoly of technical experts, together with the career paths of Japanese employees, suggests that the growth of overseas technical assistance will require greater explicit payments to industry to participate in a nationally valued but costly activity.

In sum, the government remains concerned about how it will encourage more private-sector participation in the dispatch of experts to countries requesting Japan's foreign economic assistance. Similarly, corporations are taking the initiative in some cases but waiting for government in other cases to sweeten its incentives for them to join technical assistance programs. As Japan's foreign aid program matures and more emphasis is put on human resource development, these interrelationships between the government and the private sector will become more critical.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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LDP Wins By-Election But U.N. Peace Cooperation Bill Under Assault

Japan's ruling Liberal Democratic Party won a November 4 by-election in Aichi prefecture for a seat in the Diet's upper house, despite growing public opposition to a government-proposed bill that would allow the dispatch overseas of Self-Defense Forces personnel. The victory of LDP candidate Yoshihisa Oshima to fill a vacancy created by the death of Kentaro Takagi, a member of the Komeito opposition party, was interpreted by chief cabinet secretary Misoji Sakamoto as a public vote of confidence for the ruling party. "The U.N. Peace Cooperation Law has drawn strong criticism, but the LDP candidate's win [over candidates from the Japan Socialist Party and Japan Communist Party] demonstrates that the public still has confidence in the LDP," Mr. Sakamoto said. Mr. Oshima, a former member of the Nagoya municipal assembly, garnered 45 percent of the vote, with the remainder split between the candidates from the JSP and the JCP.

enlighten the Japanese people concerning the "true nature" of the proposed U.N. Peace Cooperation Law. LDP secretary general Ichiro Ozawa, one of the most aggressive ruling party advocates of the peace cooperation bill, also said November 2 that the government will continue to push for lower house passage of the legislation before the planned November 10 adjournment of the extraordinary Diet session. "We must not leave the matter unsettled," the LDP secretary general declared. "We must have the Diet's decision on the bill through full deliberation." In a special interview with Japan Economic Journal Mr. Ozawa also let it be known that while the authors of the plan would not compromise on the basic tenets of the peace cooperation measure -- including the provision that authorizes the dispatch overseas of SDF personnel -- they would be willing to bend on some "technical points."

In an effort to buy more time the LDP secretary general proposed November 5, the close of the first full day of Diet debate on the measure, that the special session be extended by 20 days. This was rejected soundly by the opposition parties. Shun Oide, head of the JSP's Diet administration committee, objected on the grounds that "this would go against traditional rules if the LDP extended the session for its own purposes." Representatives from Komeito and the JCP concurred.

Mr. Kaifu's inability to unite his own party behind him on this issue does not bode well for the peace cooperation bill or his political future. Some Japanese political observers speculate that the prime minister may be forced to step down if he fails to get the proposal at least through the lower house. Mr. Ozawa and a few others will be waiting in the wings to pick up where he leaves off (see JEI Report No. 42A, November 2, 1990).

Barbara Wanner

ANC Leader Nelson Mandela Calls On Japan For More Assistance

African National Congress leader Nelson Mandela's October 27-November 1 trip to Japan was interpreted by some observers as a step toward a new relationship between Japan and South Africa. Japan has not had full diplomatic relations with South Africa since World War II; official contacts are maintained at the consular level. Mr. Mandela, who was invited to Japan as a national guest, addressed several themes in his meetings with Japanese government and private-sector leaders. The central message of his visit, however, was the ANC's urgent need for financial assistance.

In an October 29 meeting with Prime Minister Toshiki Kaifu Mr. Mandela contended that mere words from nations voicing opposition to the South African government's racial policy were inadequate. The antiapartheid leader requested $25 million for the ANC, particularly to aid its efforts to provide housing, jobs and education for former political prisoners and exiles. The prime minister said, however, that since "there is no precedent" for Tokyo to provide direct assistance to political organizations in other countries it would be difficult to meet the ANC request. Instead, Mr. Kaifu added, Japan would consider directing aid to the ANC through such international organizations as the United Nations. For fiscal year 1990 Tokyo has pledged Y229.8 million ($1.7 million at Y135=$1.00) through the United Nations and a Japan-European Community fund to programs and organizations working against apartheid (see Table 1).

Table 1: Japanese Support for Antiapartheid Organizations

(in thousands of yen)

Government Outlays	Actual FY 1989	Committed FY 1990
United Nations		
U.N. Trust Fund for South Africa	Y2,460	Y2,720
U.N. Trust Fund for Publicity Against Apartheid	1,230	1,360
Trust Fund for Namibia	1,230	1,360
U.N. Institute for Namibia	31,980	35,360
U.N. Educational and Training Program for Southern Africa	49,200	54,400
With European Community		
Special Joint Programs for South African Blacks	73,800	136,000
Private-Sector Contributions		
Scholarships for Black South Africans	6,298	7,000
Technical Training Center Project	141,000	135,000
Other	38,780	58,540

Source: Ministry of Foreign Affairs

Foreign Ministry spokesperson Taizo Watanabe later expanded on the funding dilemma, noting that Japan has no "legal framework" for such assistance. Mr. Mandela's visit may precipitate the establishment of a new nongovernmental organization through which Tokyo can "manage more straightforward aid efforts" to the ANC, Mr. Watanabe added. Foreign Ministry sources say that Japan has agreed to increase its funding to such nongovernmental organizations and also is considering providing the means for South Africans to train with the Japan International Cooperation Agency and extending small-scale grant assistance through its consulate-general in South Africa; however, the details of the proposals have not been resolved.

Japanese newspapers reportedly disagreed on the exact outcome of Mr. Kaifu's meeting with the antiapartheid leader, but Mr. Mandela interpreted the prime minister's response as a rejection of his request. He later told a press conference, ". . . the contribution made by the Japanese government [in support of the antiapartheid movement] is absolutely insignificant." Mr. Mandela maintains that the ANC should not be treated like other political parties but as an agency of peace in South Africa. In a meeting with Ichiro Ozawa, the Liberal Democratic Party secretary general, he urged the LDP leadership to convince the government of this status. Mr. Mandela also took his appeal for financial support for the antiapartheid movement to leaders of Japan's opposition parties and to public rallies in Tokyo, Osaka and Kyoto.

In special recognition of Mr. Mandela's decades-long leadership of the antiapartheid struggle, Japanese officials accorded him a privilege usually reserved for heads of state -- addressing the Diet. Mr. Mandela's speech to the lawmakers again emphasized the ANC's need for resources to help achieve the organization's goals. He called on Japan to share with South Africa its "advances and experience in technology, education, economics and other spheres."

The antiapartheid leader carefully addressed two issues that have been sensitive for Japan. Mr. Mandela called recent statements by Justice Minister Seiroku Kajiyama regarding American blacks a matter for Japan's voting public to resolve. The Congressional Black Caucus and others in the United States and Japan have called for Mr. Kajiyama to resign over remarks in which he compared prostitutes' incursions into a neighborhood of Tokyo to a "there-goes-the-neighborhood" reaction in America when blacks moved into previously all-white residential areas.

And, in contrast to his June visit to Washington, Mr. Mandela did not urge a continuation of economic sanctions against South Africa in his address to the Diet or in his meeting with the prime minister. In response to international concerns Tokyo imposed additional restrictions on transactions with South Africa in the fall of 1986; however, two-way trade has continued at its presanctions level. Japanese government sanctions against South Africa include bans on direct investment, the export of computers to government authorities and steel purchases (except imports already under contract). Imports of Krugerand gold coins are restrained, while private loans to that country are discouraged. Reciprocal landing rights between Japan and South Africa officially were suspended in 1986, and Japanese government employees were prohibited from using South African Airways international flights. Yet, Japan currently is South Africa's second-largest trading partner after West Germany (see Tables 2 and 3). Tokyo's approach to the problem of apartheid has emphasized dialogue and improved business ties, while Mr. Mandela argues that sanctions against South Africa should not be lifted until Pretoria's apartheid policies have been removed completely.

Table 2: Japan's Trade with South Africa, 1989

(in millions of dollars)

Imports	Amount	Exports	Amount
Steel	$337.5	Transportation Machinery	$555.1
Nonferrous Metals	278.6	Nonelectric Machinery	464.5
Coal	260.5	Electric Machinery	238.7
Nonferrous Metal Ores	175.0	Steel	75.4
Iron Ore	121.2	Precision Instruments	67.7
Gold (excl. coins)	118.0	Fabricated Metal Products	44.5
Sugar	86.8	Organic Chemicals	27.6
Other	657.2	Other	243.7
Total	2,034.8	Total	1,717.2

Source: Ministry of International Trade and Industry, 1990 Trade White Paper.

During the ANC leader's visit Foreign Ministry spokesperson Watanabe said Tokyo may lift some of its sanctions against Pretoria "because the climate and atmosphere in South Africa is changing for the better," Japanese media

Table 3: South Africa's Top Trading Partners, 1989

(in millions of dollars)

Trading Partner	Exports	Imports	Total Trade
West Germany	$3,263	$1,552	$4,815
Japan	1,737	2,047	3,784
United States	1,659	1,587	3,246
Great Britain	1,704	1,465	3,169
Italy	608	2,548	3,156

Source: International Monetary Fund, Direction of Trade Statistics.

sources said. He noted that the change in policy initially would apply only to restrictions on "exchanges of personnel and visits." Japan currently does not participate in sports, educational or cultural exchanges with South Africa. Black South Africans and those attending antiapartheid conferences in Japan are excepted from this restriction. Tourist visas to South Africans have been suspended since 1986, and Japanese tourism in that country is discouraged. Mr. Watanabe previously was quoted as saying changes were being considered because Tokyo viewed Pretoria's state of emergency, lifted in October, as the most significant obstacle to negotiating an end to apartheid.

Mr. Mandela reportedly received an enthusiastic welcome from both political leaders and the public in Japan. Although the antiapartheid leader expressed disappointment with the Japanese government's position on contributing to the ANC, Tokyo appears increasingly willing to consider alternative ways of showing its support for resolving the problems of apartheid. Mr. Mandela, who stopped in Australia, Indonesia and India before his trip to Tokyo, wrapped up his Asian tour with a visit to Malaysia.

Margo Grimm

Government Advisory Panels Call For New Land Tax

Two government advisory panels, one dealing with land policy reforms and the other looking at land taxation, separately submitted recommendations October 29 and 30 urging the government to take substantive action to decrease land prices, thereby facilitating a reasonably priced supply of housing. With land and housing prices at high levels, middle-income workers increasingly worry that they will never have the chance to buy a home. Moreover, the government is concerned that steep land prices will aggravate the gap between the haves and the have-nots. (For the Economic Planning Agency's review of this problem, see JEI Report No. 32B, August 17, 1990.)

Land prices in both commercial and residential areas have more than doubled in the past five years, which cover Japan's second-longest economic boom and a period when both stock market and real estate speculation helped to drive land prices upward. Today, residential land prices are five to 10 times the average annual income of salaried workers. Both advisory panels interpreted their mandate as dispelling the myth that land prices will never drop in Japan and that property values will continue to appreciate.

percent to an average Y56.3 ($0.42) per liter or about $1.58 per gallon. The results were not entirely as MITI would have liked -- the retail price hikes were considered on the high side, but panic-pricing was avoided.

According to both the International Energy Agency, a group formed by oil-importing nations after the oil crises of the 1970s, and MITI, the lack of refining capacity rather than crude oil supplies might cause disruptions in the future. Many countries are having difficulty replacing supplies of refined products that previously were purchased from Kuwait. IEA has warned that a cold winter will strain supplies of refined products. MITI, also worried about a refining bottleneck, has urged domestic refineries to increase output, especially of kerosene, during the last half of FY 1990. The boost in domestic refining itself could cause price disruptions in certain oil markets. Japanese distillers are rapidly building up stores of high-sulfur bunker fuel oil, the residual from refining jet fuel and distillate or light fuel oil. Other countries are worried that Japanese oil companies will be forced to dump this bunker fuel on the world market, irritating not only foreign competitors but domestic shippers, which are obliged to pay a premium of as much as $55 a ton for Japanese bunker fuel.

The government also has its eye on the long run, recently announcing a new long-term energy outlook that continues the shift away from oil. The October 30 outlook is slightly more conservative than the version submitted by an advisory panel earlier this year (see JEI Report No. 24B, June 22, 1990). Overall energy demand now is expected to grow 31.7 percent between FY 1989 and FY 2010 to 657 million kiloliters of crude oil equivalent, down from the 666 million kiloliters envisioned by the advisory panel. Oil's share of the total supply will drop from 57.9 percent in FY 1989 to 45.3 percent in FY 2010 (only slightly below the advisory body's 46 percent goal). The weight given nuclear power is 16.9 percent of all energy supplied in FY 2010, up from 8.9 percent in FY 1989, while the contribution of alternatives, such as solar power, is expected to jump from 1.3 percent to 5.3 percent over the same period.

Some observers are skeptical that the growth in Japanese energy demand can be curbed to the extent envisioned by MITI. Pointing out that the manufacturing sector already has made significant strides in energy efficiency, they question how much room is left for improvement -- particularly since Japanese firms will have to stress automation to compensate for labor force shortages. In contrast to its ability to influence the manufacturing sector, these critics add, the government's efforts to encourage consumers and the transportation sector to conserve have fallen short. These two user groups have shown the biggest increase in energy demand in the past few years and have the greatest potential for further growth. While government planners feel the nation is in good shape to handle the current Persian Gulf crisis, they understand that proper handling of energy issues will remain central to the economy's long-term growth.

Jon Choy

Trade Statistics On U.S.-Japan Services Reveal Surprises

With services now a much larger component than manufacturing in the domestic economies of all industrial countries, analysts have been eager to find out how that sector plays in international commerce. This desire has gained urgency since the Uruguay Round of multinational trade negotiations now under way addresses services trade for the first time. A multiyear effort by the Department of Commerce was far more comprehensive than previous studies and resulted in recently released data that show the United States with a strong and rapidly growing surplus in services trade with Japan. (The data refer to what is known technically as nonfactor services. In the case of U.S.-Japan trade this distinction is important mainly in that the Commerce figures omit earnings on direct and portfolio investment.) In 1989 the U.S. services trade surplus of $9.8 billion offset 20 percent of this country's merchandise trade deficit with Japan. By comparison the 1986 figures show only about a 10 percent offset.

Americans accustomed to seeing Japanese tourists in this country will not be surprised to learn that travel and passenger fares accounted for more than two-thirds of 1989's bilateral services surplus (see Table). Some of Commerce's other findings are more surprising, however. For example, American companies operating in Japan sold more services to their U.S. parent than they sourced from the United States (as reflected by the negative exports for private services among affiliated firms). Japanese firms in the United States engaged in comparable behavior. In other words, contrary to the popular image of foreign investment serving as a magnet for merchandise exports from the home country, the opposite appears true for trade in services: foreign investment leads to more imports of services from the host country.

The data also enumerate levels of trade in some services that have experienced heated trade disputes in recent years. Generally, the figures are embarrassingly small. For example, despite the continuing hoopla over construction services, the United States had a bilateral deficit in construction, engineering, architecture and mining services of only $33 million in 1989, down from $116 million in 1986. That figure represented under one-tenth of one percent of the merchandise trade imbalance between the United States and Japan in 1989. (The United States had a modest $586 million worldwide surplus in this sector.) The deficit with Japan may be overstated since imports of construction services are counted using a more inclusive concept than exports.

In legal services the U.S. surplus came to $56 million in 1989, a level little changed from earlier years. In financial services other than insurance the United States moved from deficit to surplus between 1986 and 1989, registering $109 million in black ink last year. The figure, however, omitted important interest-earning banking activities in which Japan may enjoy a surplus vis-a-vis the United States. In insurance the United States exports far more to Japan than it imports.

The numbers for many industries, whether in surplus or deficit, generally are smaller than casual observers might have expected. How can these figures be reconciled with those showing the large and growing role of Japanese service industries in the United States? The explanation is relatively simple. Services inevitably have a very high local content. Virtually all the value-added of a service is the result of salaries paid and intermediate goods and services procured locally. In short, a foreign presence does not necessarily imply a high level of cross-border trade.

These conclusions have implications for extremists of various stripes. Alarmists concerned about the growth of Japanese investment in the United

States worry needlessly that services investment will destroy American jobs. Instead, the investment is likely to add to the options available to workers in service industries and even may lead to new export-oriented employment. Those who have seen services as the solution to the bilateral merchandise trade

U.S.-Japan Trade in Nonfactor Services, 1989

(in millions of dollars)

	Exports	Imports	Balance
Travel	$6,594	$1,784	$4,810
Passenger Fares	2,484	493	1,991
Freight	877	1,888	-1,011
Port Services and Other Transportation	1,904	1,878	26
Royalties and License Fees			
Among Affiliated Firms	1,507	327	1,180
Among Unaffiliated Firms	1,026	126	900
Private Services Among Affiliated Firms			
Among Firms with Non-U.S. Ownership		-498	498
Among Firms with U.S. Ownership	-427		-427
Business, Professional and Technical Services Among Unaffiliated Firms	628	248	380
Advertising	44	74	-30
Computer and Data Processing	126	16	110
Database and Other Information Services	16	6	10
Research, Development and Testing Services	82	D	D
Management, Consulting and Public Relations Services	25	39	-14
Legal Services	60	4	56
Construction, Engineering, Architectural and Mining Services	33	66	-33
Industrial Engineering	33	1	32
Installation, Maintenance and Repair of Equipment	D	D	D
Other	D	6	D
Other Private Services Among Unaffiliated Firms			
Education	320	13	307
Financial Services	552	443	109
Insurance	973	30	943
Telecommunications	262	308	-46
Other	160	30	130
Total Nonfactor Services	16,860	7,070	9,790

*Primarily Japanese-owned firms.
D = Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce, Bureau of Economic Analysis imbalance are likely to be equally disappointed. They may have hoped that the newly expanded data on services would buttress their case by demonstrating a large U.S. advantage in new fields, such as data base services. However, the more comprehensive Commerce data show that most services trade stems from areas such as tourism and transportation, which traditionally have been well-covered by the balance of payments statistics. While most of the newly calculated sectors do show a healthy U.S. surplus with Japan, such services do not make much of a dent in the bilateral goods deficit.

Douglas Ostrom

Notes

New Administrative Reform Panel - Buttressing Tokyo's commitment to improve the quality of life in Japan and fulfill its international responsibilities, Prime Minister Toshiki Kaifu October 31 inaugurated the third Ad Hoc Council on Administrative Reform and mandated that it address vexing economic, social and political issues. Council chairman Eiji Suzuki, who has chaired the previous two such councils, told the panel of business and labor leaders that their goal is to spread the benefits of the nation's economic strength to Japanese consumers. Over the next three years the council will submit suggestions on such issues as: the cost of land, the supply of housing and other social overhead capital, coping with Japan's aging population, further liberalization of agricultural markets, the transparency of Japan's administrative rules and regulations, the government's crisis management apparatus and Japan's contributions to the international community.

The two prior administrative reform panels broadly influenced government policy. The final 1982 report of the first council led to the formation of Nippon Telegraph and Telephone Corp., Japan Tobacco Inc. and the Japan Railway Group from public corporations. The report also advocated a reduction in the size of government and deregulation of Japan's goods and financial markets. The second council's late 1988 report became the basis for a government package of market access and deregulation measures and presaged some of the subjects included in the final Structural Impediments Initiative report (see JEI Report No. 47B, December 16, 1988).

Audio Recording Protection - The Agency for Cultural Affairs outlined October 26 proposed legislation to strengthen protection for foreign audio recordings. To be presented at the next regular Diet session, the planned bill would: grant the same copyright protection to foreign recordings that Japanese artists enjoy with regard to both sales and rentals of all forms of recordings; lengthen the life of audio copyrights from 30 to 50 years; and extend copyright protection to foreign recordings made as early as 1968, which is 10 years before Japan joined the Geneva convention on international copyrights. The proposed law also includes penalties for pirating: a fine of up to Y300,000 ($2,222 at Y135=$1.00) and a one-year jail term.

The agency, part of the Ministry of Education, had hoped that such legislation would be passed in the last regular Diet session, but it was stymied by the political impasse over the 3 percent consumption tax and other issues. Disagreement between foreign recording interests and Japanese record rental stores also hindered consideration of changes sought by the United States (see

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REPORT

A Two-Part Report: A and B

NO. 44A November 16, 1990

CHIPPING AWAY: U.S. ACCESS TO JAPAN'S SEMICONDUCTOR MARKET

Summary

The July 1986 semiconductor arrangement took government and industry in the United States and Japan into the uncharted territory of managed trade. This trailblazing attempt to end predatory pricing abroad by Japanese suppliers of commodity memory products and expand sales opportunities in Japan for American competitors initially hit a dead end. The pricing controversy finally was resolved in late 1987, but transpacific wrangling over the market access provisions of the five-year accord continued to detour progress on this front. Only in the last year has the foreign-supplied (mainly American) share of Japan's semiconductor requirements budged from its historical 10 percent level.

That belated progress rules out any chance that offshore manufacturers will reach the agreement's 20 percent market share target by the July 1991 expiration date. Silicon Valley executives, convinced at last that foreign sales in the world's biggest semiconductor market are on track, are willing to give Japan until the end of 1992 to attain the 20 percent figure. But there is a catch: U.S. merchant semiconductor producers want another five-year arrangement to maintain the pressure on Japanese firms to buy foreign and to price fairly. Arguing that the current pact has opened Japan's semiconductor business to overseas suppliers and eliminated the threat of dumping, that country's electronics industry maintains that a new agreement is unnecessary. That is likely to be Tokyo's official position as well. Washington's opposition to managed trade does not automatically doom the U.S. industry proposal, though. Now that a map is available for managing bilateral trade in semiconductors, the Bush administration might decide that a new arrangement is preferable to another free-for-all.

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Off to a Contentious Start

The U.S.-Japan semiconductor trade pact, hammered out in July 1986 and signed that September, represented an unprecedented attempt to tackle Japanese trade practices that Silicon Valley and the White House charged were threatening the continued ability of the United States to compete as a world leader in integrated circuits and discrete devices (see JEI Report No. 16A, April 24, 1987). The five-year agreement committed Tokyo to improve market access for foreign producers stymied by the allegedly anticompetitive behavior of Japanese semiconductor users and to end what U.S. industry and government officials said was predatory pricing here and in third markets by Japanese manufacturers of commodity memory products. In exchange, Washington suspended two outstanding dumping complaints against Japanese vendors -- one involving EPROMs (erasable programmable read-only memories) and the other 256-kilobit and higher-density DRAMs (dynamic random access memories). It also suspended the unfair trade practices proceeding initiated by the Semiconductor Industry Association under Section 301 of the 1974 Trade Act.

Instead of moving the United States and Japan beyond their five-year-old fight over the competitive impact on American rivals of Japanese semiconductor trade practices at home and abroad, the 1986 pact almost immediately plunged the two countries into a new controversy over implementation. Compliance issues involving both the pricing and the market access provisions of the accord pitted government against government and trade association against trade association, transforming seemingly natural allies into adversaries.

Charges that Tokyo was not enforcing the pricing part of the agreement surfaced quickly, followed just as quickly by warnings from the Reagan administration that Japan's semiconductor makers had to stop dumping EPROMs and DRAMS overseas, or else. The "or else" turned out to be penalty tariffs levied in April 1987 on $135 million worth of Japanese-made products imported into the United States. Retaliation, a White House first, worked. By early November 1987 U.S. government and industry officials were satisfied that commodity memory devices were being priced at fair market values both in this country and in third markets. The sanctions were lifted.

The same initial sequence of events unfolded on the market access issue -- early complaints about implementation, threats of reprisals if progress did not occur quickly and penalty tariffs to the tune of $165 million in April 1987 for Japan's failure to improve foreign access to its semiconductor business. The outcome was entirely different, however. The dumping-related sanctions succeeded in large part because the Ministry of International Trade and Industry had tools at its disposal to prod Japanese suppliers into compliance with the trade pact's pricing provisions. Without this backup on the market access side the punitive duties proved no more effective than the 1986 agreement itself in persuading Japanese semiconductor customers to boost purchases from American manufacturers. At best the sanctions -- which remain in effect to this day -- helped U.S. competitors in the boom market of 1987 and 1988 to recapture the roughly 10 percent of Japanese demand they traditionally had supplied before losing ground during the 1985-86 worldwide semiconductor slump.

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With American companies barely filling their historical share of Japan's semiconductor requirements, the Semiconductor Industry Association and the Electronic Industries Association of Japan realized they both had a practical interest in backstopping the efforts of individual U.S. suppliers and Japanese customers interested in expanding business ties. Three industry-to-industry meetings were held between June 1987 and the following June to work out a joint program of action, but each of these sessions ended in controversy over exactly what Tokyo had promised in the market access section of the trade agreement.

In retrospect, this infighting probably should have been expected, at least at first, given the high stakes for both sides and the broadbrush language of the publicly released accord. While SIA had made it clear during the nine months of negotiations leading up to the agreement that its yardstick for success was a 20 percent U.S. share of Japan's semiconductor market by the arrangement's end in July 1991, the pact neither mentioned a target Japanese market share for American semiconductor makers nor guaranteed greater U.S. sales in Japan. All it specified was that Washington and Tokyo anticipated a "steady increase in access" over the agreement's five-year term.

In the 1987 and 1988 meetings American industry executives contended that Tokyo had recognized SIA's market share expectations when it signed the trade agreement. That acknowledgment, they hinted, was contained in a confidential side letter to the pact. EIAJ officials repeatedly denied that the Japanese government had made any promises, written or otherwise, about a market share figure for American suppliers. Publication of the side letter in 1988 did not end this dispute since the relevant language was open to interpretation: "The Government of Japan recognizes the U.S. semiconductor industry's expectation that semiconductor sales in Japan of foreign capital-affiliated companies will grow to at least slightly above 20 percent of the Japanese market in five years. The Government of Japan considers this can be realized and welcomes its realization."

Mirroring what happened when representatives of the two governments got together during this period, SIA and EIAJ went around and around on whether this wording constituted the equivalent of a guarantee, the U.S. position, or a goal, as the Japanese maintained. The two sides also got hung up on how to track the "steady increase in access" called for in the public part of the arrangement. SIA's leadership argued that "steady" meant something close to a straight-line expansion in market share. Spokesmen for the Japanese trade group rejected this argument -- the basis for SIA claims that Japan was not living up to its market access commitments, saying that nothing in the agreement entitled foreign suppliers to a linear gain in market share.

The size of the foreign market share and how to calculate it sidetracked SIA and EIAJ as well. Washington and Tokyo had agreed in initialing the trade pact to develop a new method for measuring access to avoid controversy on this critical point. In the meantime, they indicated, the two sides would use data collected by MITI on semiconductors purchased by 63 big Japanese users from foreign-headquartered companies and shipment information generated by World Semiconductor Trade Statistics Inc., a reporting program covering 60 American, European and Japanese suppliers. Still in place today, that stopgap solution gave immediate rise to transpacific sparring because the quarterly MITI figures on the share of Japan's semiconductor business won by foreign-based manufacturers run anywhere from 2 to 4 percentage points higher than the comparable WSTS numbers (see Table 1).

Table 1: Foreign Share and Sales in Japan's Semiconductor Market

			MITI/Foreign			SIA/United States	
		WSTS/Foreign Share	Share	Sales (billion yen)	Sales (million dollars)	Share	Sales (million dollars)
1986:	I	n.a.	n.a.	n.a.	n.a.	8.0%	$178.7
	II	n.a.	n.a.	n.a.	n.a.	8.5	224.0
	III	8.6%	10.3%	Y38.6	$248.0	8.4	241.9
	IV	8.7	11.1	38.0	237.0	8.5	230.8
1987:	I	8.8	12.2	35.8	234.0	8.6	229.8
	II	9.2	12.8	39.1	274.0	9.0	268.7
	III	10.1	12.5	48.3	329.0	9.8	318.7
	IV	10.2	12.4	52.6	389.0	10.0	384.1
1988:	I	10.3	12.2	52.4	409.0	10.7	426.8
	II	10.4	12.9	58.5	465.0	10.6	473.2
	III	10.9	13.0	65.6	490.0	11.1	501.1
	IV	10.6	13.2	67.7	540.0	10.5	533.3
1989:	I	10.9	13.2	67.4	523.0	10.7	511.1
	II	11.5	14.9	76.8	555.0	10.8	524.2
	III	12.0	15.9	81.0	569.0	11.2	533.7
	IV	12.9	16.3	87.8	614.0	12.1	576.6
1990:	I	13.0	17.2	83.8	564.0	12.2	531.3
	II	13.3	17.5	92.5	597.0	12.5	559.3

Both data series track integrated circuits and discrete devices made by American and other foreign-based semiconductor producers and sold in Japan. Whether the product is manufactured at home, in Japan or in third countries is immaterial; all that counts is the nationality of the supplier. (By definition, therefore, imports from the offshore subsidiaries of Japanese semiconductor makers are excluded from the two sets of statistics.) MITI and WSTS also treat the output of foreign-affiliated companies in Japan similarly, counting a product as foreign if the foreign parent owns 50 percent or more of the manufacturing operation.

The biggest of the several methodological differences between the two organizations is how they handle chip production and imports by IBM Japan Ltd. In line with U.S. thinking, WSTS excludes these numbers on the grounds that IBM Japan uses all of the huge volume of devices it makes or imports from its parent in-house. MITI, however, includes them -- a move that accounts for perhaps half of the gap between its foreign market share statistics and WSTS's. Most of the rest reportedly reflects divergent methods for calculating the size of the Japanese semiconductor market, the ratio's denominator, with WSTS's figure topping MITI's by roughly 10 percent.

Moving Beyond Debates

Industry and government on both sides of the Pacific spent vast amounts of energy playing the various versions of the numbers game during the first half of the five-year semiconductor trade pact. By late spring 1989, however, the tone of bilateral meetings, both trade association-sponsored and at the official level, had changed. The charges and countercharges did not disappear entirely, but the two sides managed to put their differences aside long enough to come up with initiatives designed to facilitate U.S. sales of semiconductors in Japan.

Why the change in atmosphere? Some tough talk by the new Bush administration's top trade officials, U.S. Trade Representative Carla Hills and Commerce Secretary Robert Mosbacher, certainly played a role. Their statements that Japan had promised American companies 20 percent of the semiconductor market by 1991 and their willingness to consider additional sanctions to ensure compliance with this pledge no doubt helped persuade Japanese industry and government officials that, rightly or wrongly, a 20 percent U.S. market share was the standard by which Washington would judge the success of the trade agreement.

The catalyst, though, appeared to be SIA's decision to lobby the White House to make semiconductors a U.S. trade-liberalization priority under the Super 301 provision of the 1988 trade act. The trade group knew its March 1989 campaign could backfire. Any doubts were dispelled when Japanese industry representatives and government officials separately warned the administration that naming semiconductors a priority trade practice would entitle Tokyo to cancel the 1986 agreement. But executives of U.S. companies producing ICs and discrete devices were willing to run this risk to drive home the message that American competitors were dissatisfied with their access to Japan's market.

SIA's gamble paid off. Although semiconductors did not make the White House's final May 1989 list of priority Japanese trade practices, the strong possibility that they might have been cited accomplished what the April 1987 sanctions and the threat of additional retaliation had not achieved: it spurred the Japanese side to action. Over the last 18 months EIAJ and SIA, working alone or in tandem, have mapped out multiple initiatives to facilitate the development of long-term relationships between U.S. semiconductor suppliers and Japanese semiconductor customers -- recognized by both groups as the key to breaking the business-as-usual habits of Japan's volume chip users and getting existing and/or new American parts designed into final products.

The two trade organizations have targeted many of their efforts at Japanese consumer electronics and automotive manufacturers, huge user groups that traditionally have been hard sells for foreign makers. An EIAJ-SIA task force on consumer electronics, organized in June 1989, conducted three surveys to assist American producers in planning their Japanese marketing strategies, including a projection of Japanese market growth by consumer product line through 1995, a review of the suitability of U.S. semiconductors for Japanese consumer electronics products and a study of Japanese chip packaging requirements. A separate committee was set up that November to help American companies get in on the ground floor of the potentially big market for ICs in high-definition television equipment by, for example, hosting technical symposia. In June 1990 EIAJ and SIA, together with the Japan Automobile Parts Industries Association, established a task force on automotive semiconductors.

While the two trade associations were running interference for U.S. competitors in the consumer and automotive fields, the User's Committee of Foreign

Semiconductors -- an EIAJ-backed group comprising 57 companies that together generate roughly 70 percent of Japan's semiconductor demand -- was organizing purchasing missions and other face-to-face contacts between Japanese users and American suppliers. Washington and Tokyo also arranged a December 1989 U.S. buying mission. Some of Japan's largest chip users sent their own procurement teams to the United States to purchase existing products or contract with U.S. makers for the development of customized circuits. MITI, meanwhile, stepped up its jawboning of major semiconductor buyers, urging them to expand purchases of foreign products, set up in-house groups responsible for promoting the use of foreign semiconductors, devise and publicize annual purchasing plans, and sign more design-in contracts with offshore manufacturers.

Bumping Up Against Deadlines

Will these moves and other industry, company and government initiatives enable American and other foreign manufacturers to win 20 percent of Japan's semiconductor business by next July? If steps like these had been taken in the first year of the semiconductor trade pact instead of the fourth or fifth, U.S. corporate executives say, foreign competitors certainly would have had a fighting chance. Now it's too late. The numbers are moving in the right direction, whether the gauge is WSTS's or MITI's market share figures or the apparent consumption statistics presented in the Appendix, but too much ground still must be covered. Design-in arrangements -- near the top of the list of strategies for U.S. suppliers trying to make Japanese market inroads -- take 12 months or more to produce volume shipments, and many of these contracts were signed only this year. In any event it is not clear that enough design-in deals with American suppliers have been signed to have a noticeable effect on the market share numbers. The only aggregate data available, collected by MITI, date back just to the start of 1989, and these quarterly figures do not yet show a sustained increase.

Japanese corporate executives have doubts that earlier efforts on their part would have put American semiconductor makers within striking distance of a 20 percent Japanese market share by now. U.S. producers might supply 52.4 percent (1989) of world semiconductor demand outside Japan, they note, but these companies operate with multiple handicaps in the world's largest semiconductor market. For starters, Japan's biggest users of ICs and discrete devices also are its biggest semiconductor manufacturers, supplying a substantial portion of their requirements internally. This situation, however, has not been the major obstacle that some people anticipated. The largest of the huge, vertically integrated electronics companies have been far more willing to source semiconductors from foreign vendors than their smaller counterparts and other second- or third-tier semiconductor users that do not have an in-house supply capability, such as the automotive firms.

For example, NEC Corp., the world's top semiconductor maker last year, already gets from foreign firms 20 percent or so of the reported $1.3 billion worth of chips it buys a year from outside suppliers, and it expects to reach the 24 percent level by next July. Likewise, Mitsubishi Electric Corp., the number-five semiconductor manufacturer, and Oki Electric Industry Co., Ltd., another Big 10 producer, are at or above the 20 percent mark. Toshiba Corp., which vies with NEC for semiconductor industry leadership, expects to reach the target market share number during the current fiscal year. The same goes for Hitachi, Ltd., the third-biggest maker, and number-four Fujitsu, Ltd. Sony

Corp., also among Japan's 10 largest semiconductor companies, says it will be there by July 1991. So does Matsushita Electric Industrial Co., Ltd., the sixth-largest producer, which, along with its group companies, purchases about the same volume of semiconductors from outside vendors as NEC does.

Then there's the mismatch problem -- shorthand in Japan for the fact that the U.S. semiconductor industry's product strengths do not jibe well with Japanese requirements. Roughly one-third of all semiconductors used in Japan go into consumer electronics products, particularly videocassette recorders, audio equipment and television sets -- a sector that generates perhaps 4 percent of demand in this country. Consumer electronics products require significant quantities of custom and semicustom chips, which explains why most well-known Japanese makers of this equipment also are in the semiconductor business. American producers still are strong in ASICs (application-specific ICs or chips tailored to the needs of customers) despite mounting pressure from their Japanese rivals, but they must get their foot in the door to parlay this strength. Consumer electronics products also use large volumes of discrete devices, an area where U.S. makers have substantial production capability. Japanese companies say, however, that much of what is made is unsuited to their requirements because the packaging is not right.

The other big semiconductor end-use markets in Japan are computers and telecommunications equipment; together they account for roughly half of all demand versus just under two-thirds in the United States. By one count 40 percent of the chips used by Japanese makers of data-processing and telecommunications equipment are memory products. Some of these requirements are for EPROMs and SRAMs (static RAMs), products in which the United States is very competitive, especially in the high-speed area. But the parts in greatest demand are DRAMs, and this is where the U.S. industry comes up short both at home and in Japan. (Why is one of the sticking points between the two countries.) Only three American semiconductor makers are in the merchant DRAM business today -- Texas Instruments Inc., Motorola, Inc. and Micron Technology Inc.; they produce a modest 10 percent or so of the world DRAM supply compared to an overwhelming 80 percent-plus share for their Japanese rivals. Moreover, the vast majority of DRAMs made by the American trio goes to domestic customers worried about total dependence on Japanese semiconductor makers that often are competitors in the computer or the telecommunications equipment fields.

While the limited U.S. DRAM presence unquestionably hamstrings the ability of domestic companies to compete for the large semiconductor business of Japanese computer and telecommunications equipment manufacturers, an estimated 60 percent of their requirements potentially is up for grabs. Most of this demand is for microprocessors, microcontrollers and related chips or for other logic products. These are areas in which American competitors still excel despite concerted efforts by their Japanese rivals. Intel Corp., Motorola and other U.S. makers remain the Japanese market leaders in both older-technology 8- and 16-bit MPUs and current-generation 32-bit MPUs. EIAJ executives concede as much but argue that U.S. strengths in MPUs and other CMOS (complementary metal-oxide-silicon) logic and memory devices do not compensate fully for American shortcomings in DRAMs or specialized consumer electronics parts.

Japanese industry leaders also question the commitment of American semiconductor manufacturers to the Japanese market in wondering aloud whether a 20 percent market share is a realistic figure for U.S. companies. These often-expressed doubts rile American makers. Top merchant suppliers say they have invested considerable resources -- both financial and personnel -- in their Japanese marketing and support operations since the signing of the semiconductor trade pact even though there was little prospect of a short-term payoff. A September 1989 SIA study indicated that U.S. merchant makers had opened 28 sales offices, 13 design centers and four testing and failure analysis centers in the postagreement period, boosting the number of Japan facilities to 67 sales offices, 18 design centers and 26 testing and failure analysis centers.

An independent survey by the Japan Economic Institute provides additional evidence of a strong and increasing U.S. commitment to the Japanese semiconductor market (see Table 2). At least 25 merchant manufacturers have Japanese semiconductor sales subsidiaries, and 13 operate design centers. The top five U.S. semiconductor companies -- Motorola, Texas Instruments, Intel, National Semiconductor Corp. and Advanced Micro Devices, Inc. -- have had Japanese marketing operations since the late 1960s or the first half of the 1970s. Like other American semiconductor makers with a long-established Japanese marketing presence, these suppliers use both direct sales forces operating out of multiple offices and distributors to sell their products; all of them have taken steps since the trade pact went into effect to bolster this network. TI, for example, now runs nine sales offices in Japan and works with 10 distributors; Intel has six sales agents.

Big American chipmakers have paid particular attention in recent years to the design side of their Japanese business, more convinced than ever that a strong in-country design capability is the key to expanded sales. These firms have hired additional engineers and other technical personnel and installed new computer-aided engineering equipment to demonstrate to consumer electronics manufacturers and other volume buyers of custom and semicustom chips that they want some of these orders.

EIAJ executives long have argued, however, that it will take more than extra effort by the biggest American merchant producers to raise the U.S. semiconductor share in Japan. The five largest suppliers already generate the vast majority of American sales in Japan, they note; to boost this figure smaller companies must get more involved. In fact, second- and third-tier merchant makers have accounted for a significant part of the Japan-related investment activity since the signing of the trade pact. Three Fortune 100 companies that make chips for outside sale -- American Telephone & Telegraph Co., Raytheon Co. and Rockwell International Corp. -- spun off their Japanese semiconductor marketing operations from their Tokyo headquarters in the late 1980s and formed dedicated sales subsidiaries. More significant perhaps, at least seven Silicon Valley start-ups have opened Japanese sales subsidiaries, gambling that the high cost of this move relative to their revenues will pay off in the long run.

Moreover, small but strong niche players that decide they cannot justify the cost of a sales subsidiary and/or design center are not at a competitive disadvantage in the Japanese market if they sign up with the right distributor. Unlike their American counterparts, the major Japanese distributors provide design services for customers and have the equipment to do quality assurance testing and failure analysis; they also afford small merchant makers some financial protection. Micron Technology, which had not sold its products in Japan since closing its sales subsidiary there in late 1985, tried a different tack. A year ago it gave Sanyo Electric Co., Ltd. exclusive Japanese distribution rights to its complete line of DRAMs, SRAMs and video RAMs.

Table 2: U.S. Merchant Semiconductor Manufacturers With Japanese Sales Subsidiaries

				Design Center		
Parent	Subsidiary	Year Opened	Main Semiconductor Product Lines	Year Opened	Location	Products
Texas Instruments Inc.	Texas Instruments Japan Ltd.	1968	MOS memory; MOS logic; bipolar logic; bipolar memory	1969 1980 1986	Tokyo Miho Hiji	Full range of custom and semicustom products, mainly for in-house use - also has regional technology centers in Tokyo and Osaka that provide similar services for customers
Motorola, Inc.	Nippon Motorola Ltd.	1968	MOS logic; MOS memory; bipolar logic	1970s 1989	Tokyo Osaka	Full range of custom and semicustom products for in-house and customer use
Analog Devices, Inc.	Analog Devices K.K.	1969	Digital-to-analog/analog-to-digital converters	1982	Shiroyama	D-A/A-D converters
National Semiconductor Corp.	National Semiconductor Japan Ltd.	1972	Analog circuits; bipolar logic; MOS logic; microprocessors, microcontrollers, imagining/peripheral circuits	1980	Tokyo	CLASIC products
Advanced Micro Devices, Inc.	Advanced Micro Devices K.K.	1974	Microprocessors, microcontrollers/peripheral circuits; bipolar logic; analog circuits; programmable logic devices	1987	Atsugi	Semicustom products
Signetics Corp.	Philips Japan Ltd.	1975	Linear circuits; bipolar logic; microprocessors, microcontrollers/peripheral circuits	1981	Tokyo	Analog circuits; microprocessors/microcontrollers
Intel Corp.	Intel Japan K.K.	1976	Microprocessors, microcontrollers/peripheral circuits; EPROMs; flash memories	1980	Tsukuba	MOS logic/memory products
Zilog, Inc.	Zilog Japan K.K.	1977	Microprocessors, microcontrollers/peripheral circuits, incl. communications devices; application-specific standard products	--	--	--
Sprague Technologies Inc.	Sprague Japan K.K.	1981	Power/smart power circuits; Hall-effect/smart Hall-effect circuits	--	--	--
LSI Logic Corp.	LSI Logic K.K.	1984	MOS logic	1984	Tokyo	ASIC products
Linear Technology Corp.	Linear Technology K.K.	1985	Analog circuits; regulator chips; OpAmps	--	--	--
International Rectifier Corp.	International Rectifier Far East Ltd.	1986	Field-effect transistors; power circuits	--	--	--
VLSI Technology Inc.	VLSI Technology K.K.	1986	ASIC products	1986 1990	Tokyo Osaka	ASIC products ASIC products

Table 2: U.S. Merchant Semiconductor Manufacturers With Japanese Sales Subsidiaries (continued)

Parent	Subsidiary	Year Opened	Main Semiconductor Product Lines	Design Center Year Opened	Design Center Location	Design Center Products
Integrated Device Technology Inc.	Integrated Device Technology K.K.	1987	SRAMs; MOS specialty memories; microprocessors; MOS logic	--	--	--
Standard Microsystems Corp.	Toyo Microsystems Corp.	1987	ASIC products	1987	Tokyo	ASIC products
Raytheon Co.	Raytheon Semiconductor International Co.	1987	Digital/analog ASIC products; linear standard circuits; PROMs; signal devices	1989	Tokyo	ASIC ECL/ASIC analog products
Sipex Corp.	Nippon Sipex Corp.	1987	Digital-to-analog converters	--	--	--
American Telephone & Telegraph Co.	AT&T Microelectronics	1988	ASIC products; digital signal processors; SRAMs; ISDN circuits; small power supplies; lightwave products	1989	Tokyo	MOS/bipolar products
Rockwell International Corp.	Rockwell International Japan Co., Ltd.	1988	Communications devices, especially for data modem and facsimile applications	1989	Tokyo	Communications devices
Xicor, Inc.	Xicor Japan K.K.	1988	Nonvolatile memories	--	--	--
Cypress Semiconductor Corp.	Nippon Cypress K.K.	1988	SRAMs	--	--	--
Lattice Semiconductor Corp.	Lattice Semiconductor Corp. Japan	1989	Programmable logic devices	--	--	--
Xilinx Inc.	Xilinx K.K.	1989	Field-programmable gate arrays	--	--	--
Cirrus Logic Inc.	Cirrus Logic K.K.	1989	Disk, graphics/data communications controller circuits	--	--	--
Altera Corp.	Altera Japan K.K.	1990	Electrically programmable logic devices	--	--	--

Source: Japan Economic Institute survey.

While labeling recent moves by big U.S. merchant makers and small industry members alike as steps in the right direction, the conventional wisdom in Japan is that American semiconductor producers will remain marginal players in the world's largest chip market unless they have a production capability there. Four companies now have Japanese plants: pioneering TI, which operates three wafer fabrication-assembly and test complexes; Motorola, which also has a wholly owned integrated facility but additionally is an equal partner with Toshiba in a front end; Analog Devices, Inc. (an assembly and test plant); and LSI Logic Corp., which runs a front end with Kawasaki Steel Corp. (see Table 3). The other major U.S. merchant suppliers have concluded that their near-term sales prospects in Japan do not justify the several hundred million dollars it costs to build a front end, particularly when they have ample, often new, wafer fabrication capacity in this country and elsewhere. The counterargument -- that Japanese sales never may be large enough to justify a plant without building the plant first -- does not sway them. Texas Instruments and Motorola still are not able to break from the pack of also-rans in Japan despite having made all the supposedly right moves, these companies note.

Texas Instruments, however, is making another attempt. Next year it will round out its Japanese operations with the opening of a research and development center at Tsukuba, northeast of Tokyo. Expected to cost $40 million for the first of several phases to be built over the next few years, the facility will focus on new process technologies and ICs potentially applicable to advanced consumer electronics products, including high-definition television, computers, telecommunications equipment and motor vehicles. As the first American electronics company to set up a R&D center in the country, TI hopes to convince Japanese semiconductor users at last of its commitment to the market.

This investment decision has been applauded by U.S. industry analysts, but a number of them have reservations about TI's lastest Japan-related move, a plan to build a $350 million wafer fab with Kobe Steel, Ltd. A minority partner in the operation, TI will supply design and manufacturing technologies for CMOS logic devices and get all of the plant's output; Kobe Steel, in its maiden venture into semiconductor production, will put up most of the money. The American company described the March 1990 deal as "the latest in a series of creative arrangements by TI to add production capability in various regions of the world while reducing the financial risk inherent in the addition of large amounts of new capacity."

While the partnership with Kobe Steel might make eminent financial sense to Texas Instruments, critics point out that the steelmaker gets access to advanced U.S. technology. This raises the possibility of more cutting-edge American know-how being transferred to Japan's electronics industry, they say. Similar warnings were issued in late 1986 when Motorola unveiled plans to transfer its microprocessor technology indirectly to Toshiba through their now operational Japanese production venture in exchange for help in getting back into the DRAM business. They were heard again at the end of 1988 when TI agreed to cooperate with Hitachi on the development of a 16-megabit DRAM device, as well as other times in recent years that U.S. semiconductor companies have announced technology transfer or joint development arrangements with Japanese rivals.

Repeating what they said when the Hitachi deal was announced, TI executives say that the pact with Kobe Steel has been structured to provide strong protection for the company's technology. Motorola takes the same position on

Table 3: U.S. Merchant Semiconductor Manufacturers With Japanese Production Facilities

Subsidiary/ Parent	Location	Year Opened	Processes	Products	Comments
Texas Instruments Japan Ltd. Texas Instruments Inc. - 100%	Hatogaya, Saitama	1968	Wafer fabrication, assembly and test	MOS logic products	Roughly four-fifths of the products Texas Instruments makes in Japan are sold there.
	Hiji, Oita	1973	Wafer fabrication, assembly and test	Bipolar logic/memory products	
	Miho, Ibaraki	1980	Wafer fabrication, assembly and test	MOS memory products	
Nippon Motorola Ltd. Motorola, Inc. - 100%	Aizu, Fukushima	1980	Wafer fabrication, assembly and test	MOS/bipolar logic products; MOS memory products	Plant's output expected to be doubled by 1994 after being expanded 50 percent in 1987.
Analog Devices K.K. Analog Devices, Inc. - 100%	Shiroyama, Kanagawa	1982	Assembly and test	Digital-to-analog/analog-to-digital converters and related circuits	Wafers are imported from United States and Ireland. Factory assembles about half of the products Analog Devices sells in Japan.
Nihon Semiconductor Inc. LSI Logic Corp. - 55% Kawasaki Steel Corp. - 45%	Tsukuba, Ibaraki	1987	Wafer fabrication	Silicon wafers; ASIC products	Plant's output is marketed by LSI Logic in Japan, the United States and other markets.
Tohoku Semiconductor Corp. Motorola, Inc. - 50% Toshiba Corp. - 50%	Sendai, Miyagi	1988	Wafer fabrication	MOS memory (DRAM)/logic (MPU) products	Motorola contributed designs and technology for broad range of microprocessors, while Toshiba transferred DRAM and SRAM designs and technology. Plant makes 1-megabit DRAMs for Motorola and 8- and 16-bit MPUs for Toshiba.
Nippon Motorola Ltd. Motorola, Inc. - 100%	Sendai, Miyagi	1991*	Assembly and test	MOS memory (DRAM)/logic (MPU) products	Wafers will be supplied from adjacent Tohoku Semiconductor front end.
KTI Semiconductor Ltd. Texas Instruments Inc. - 25% Kobe Steel, Ltd. - 75%	Nishiwaki, Hyogo	1992*	Wafer fabrication	CMOS logic devices, including ASIC/VLSI circuits	All wafers will be supplied to Texas Instruments Japan for resale in Japan and abroad. TI is providing product and process technologies, while Kobe Steel is financing most of the plant's cost.

*Planned.

Source: Japan Economic Institute survey.

its five-year agreement with Toshiba. But even if the technology safeguards in these and other arrangements with Japanese manufacturers prove effective, U.S. industry analysts still worry that the high and rising costs of R&D and production in the semiconductor business will tempt merchant makers to substitute tie-ups with deep-pocketed Japanese firms for their own efforts. That outcome, they say, could undercut the competitive position of the critical U.S. semiconductor industry.

A New Trade Pact?

Despite their complaints over the years about Japanese implementation of the terms of the semiconductor trade pact, U.S. merchant makers still believe they made the right decision in 1986 when they opted for this arrangement rather than statutory trade relief. The agreement, they readily admit, ended Japanese pricing pressures on surviving American producers of DRAMs and EPROMs and eliminated the threat of dumping in ASICs, MPUs and several other products subject to price monitoring. SIA also argues that the modest inroads U.S. suppliers have made in Japan's semiconductor market over the last 12 months or so would not have occurred without the accord.

That assessment persuaded the trade association's leadership months ago that some type of institutional framework had to be kept in place after the July 1991 expiration of the trade agreement if U.S. manufacturers ever were to be more than bit players in Japan's semiconductor market. The big question was how to get ongoing market access help as well as continued relief on the pricing front. The 1986 pact said nothing about extension, leaving negotiation of another arrangement the only alternative. Industry officials knew this was easier said than done since a SIA campaign for a new agreement most certainly would encounter stiff resistance on all sides.

Big domestic chip users, especially computer manufacturers, have been unhappy with the semiconductor trade pact from the start, blaming its pricing provisions for initially short supplies of commodity memory products on the American market and artificially high DRAM and EPROM prices to this day. The Bush administration's frequent arguments against managed trade also put it in the opposition camp. Industry and government in Japan were sure to oppose a new agreement as well given the widespread belief there that Japanese semiconductor makers and users have done more than their fair share to help U.S. merchant manufacturers.

SIA decided to tackle opponents of a new trade pact in order. Trade association representatives began meeting early this year with members of the Computer Systems Policy Project, a group of 11 leading U.S. computer makers, to try and find common ground. After months of give-and-take the two organizations came up with a unified position in early October. In a joint letter to President Bush SIA and CSPP urged the White House to seek a new five-year semiconductor trade pact with Japan effective August 1, 1991. Bowing to the computer makers, semiconductor suppliers agreed to give up fair market value floor prices on imports of Japanese-made DRAMs and EPROMs and rely instead on a fast-track antidumping mechanism for pricing protection. In exchange, SIA won CSPP support for its market access initiatives.

Under the joint proposal Japan would be given an extra 17 months, or until December 1992, to fill its 20 percent foreign market share "commitment." If offshore suppliers do not win this cut of Japan's semiconductor business by the end of the grace period, the White House should take appropriate action, the two trade groups said without indicating what those steps might be. Then in 1993 Washington and Tokyo would decide whether new, presumably higher, quantitative targets needed to be set to continue progress toward an open Japanese semiconductor market. Questioned on this point at a press conference announcing the joint proposal, SIA and CSPP representatives refused to say whether they thought the new targets should be set in terms of market share.

The top EIAJ official immediately rejected the proposed new trade pact, saying another arrangement is unnecessary. That certainly is not the last word from the Japanese side. U.S. semiconductor industry executives know, however, that even if Tokyo were to agree to discuss another accord -- certainly a long shot -- a push for a fixed foreign market share figure could scuttle the talks. First, though, merchant makers must sell the SIA-CSPP proposal to the Bush administration. Ironically, Washington watchers think the pricing parts of the suggested new arrangement could present more problems than the managed trade thrust of the market access sections. Whether they are right will be known in the next few months.

For further information, contact Susan MacKnight.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published November 23, 1990 because of the Thanksgiving holiday. The next issue will be dated November 30, 1990.

APPENDIX

Table 1: Japan's Apparent Domestic Consumption of Semiconductors, 1985-90*

	1985	1986	1987	1988	1989	Six Months 1990
	(in millions of yen)					
Total Production	Y2,409,703	Y2,332,811	Y2,486,839	Y3,119,104	Y3,594,137	Y1,708,037
Total Exports (f.o.b.)	696,556	639,268	723,779	1,014,521	1,336,675	661,102
Total Imports (c.i.f.)	199,424	172,763	189,082	256,737	351,659	205,984
Trade Balance	497,132	466,505	534,697	757,784	985,016	455,118
Apparent Domestic Consumption	1,912,571	1,866,306	1,952,142	2,361,320	2,609,121	1,252,919
Exports as Percent of Apparent Domestic Consumption	36.4%	34.3%	37.1%	43.0%	51.2%	52.8%
Imports as Percent of Apparent Domestic Consumption	10.4%	9.3%	9.7%	10.9%	13.5%	16.4%
Exports to United States (f.o.b.)	248,325	185,937	217,008	313,912	461,391	220,824
Imports from United States (c.i.f.)	136,093	117,865	126,529	175,857	232,795	139,700
Trade Balance	112,232	68,072	90,479	138,055	228,596	81,124
Exports to United States as Percent of Apparent Domestic Consumption	13.0%	10.0%	11.1%	13.3%	17.7%	17.6%
Imports from United States as Percent of Apparent Domestic Consumption	7.1%	6.3%	6.5%	7.4%	8.9%	11.1%
	(in thousands of dollars)					
Total Production	$10,101,882	$13,842,933	$17,193,301	$24,339,477	$26,052,022	$11,268,221
Total Exports (f.o.b.)	2,898,814	3,760,621	4,960,788	7,917,904	9,732,598	4,383,094
Total Imports (c.i.f.)	830,345	1,015,775	1,294,993	2,003,410	2,561,992	1,366,757
Trade Balance	2,068,469	2,744,846	3,665,795	5,914,494	7,170,606	3,016,337
Apparent Domestic Consumption	8,033,413	11,098,087	13,527,506	18,424,983	18,881,416	8,251,884
Exports to United States (f.o.b.)	1,033,439	1,093,811	1,487,375	2,449,949	3,359,480	1,464,059
Imports from United States (c.i.f.)	566,653	692,997	866,578	1,372,275	1,696,015	926,946
Trade Balance	466,786	400,814	620,797	1,077,674	1,663,465	537,113

*Neither Japan's production data nor its trade data include wafers, dice or parts.

Source: Derived from following tables.

Table 2: Japan's Production of Semiconductors, 1985-89

(value in millions of yen*; quantity in thousands of units)

	1985	1986	1987	1988	1989
Value					
Integrated Circuits	Y1,841,790	Y1,780,235	Y1,925,000	Y2,489,897	Y2,941,597
Analog	350,333	336,953	341,646	361,785	379,171
For Industrial Equipment	70,588	83,764	112,797	119,086	117,639
For Consumer Goods	279,745	253,189	228,849	242,699	261,532
Digital Bipolar	256,076	273,379	262,450	272,519	226,676
Logic	214,827	230,042	218,296	219,243	186,535
Memories	41,249	43,337	44,154	53,276	40,141
Digital MOS	1,070,965	1,000,919	1,137,813	1,629,630	2,097,461
Logic	482,095	484,848	567,754	708,680	944,600
Microprocessors, Microcontrollers and Peripheral Chips	n.a.	n.a.	239,674	280,593	398,190
Other	n.a.	n.a.	328,080	428,087	546,410
Memories	588,870	516,072	570,059	920,951	1,087,695
RAMs	n.a.	n.a.	n.a.	n.a.	900,607
ROMs	n.a.	n.a.	n.a.	n.a.	187,088
Other	n.a.	n.a.	n.a.	n.a.	65,166
Hybrid	164,417	168,983	183,091	225,962	238,289
Discrete Devices	567,913	552,576	561,839	629,207	652,540
Transistors	206,205	196,015	201,470	230,906	242,862
Diodes and Rectifiers	142,752	139,890	139,467	151,152	150,785
Other	218,956	216,671	220,902	247,149	258,893
Total Production	2,409,703	2,332,811	2,486,839	3,119,104	3,594,137
Quantity					
Integrated Circuits	9,350	11,139	12,015	14,296	15,083
Analog	3,624	3,959	4,372	5,185	5,782
For Industrial Equipment	646	1,040	1,330	1,698	1,827
For Consumer Goods	2,978	2,919	3,042	3,487	3,955
Digital Bipolar	1,882	2,380	2,307	2,377	1,860
Logic	1,838	2,334	2,255	2,315	1,827
Memories	44	45	52	61	33
Digital MOS	3,485	4,373	4,878	6,197	6,849
Logic	2,358	2,896	3,453	4,435	5,092
Microprocessors, Microcontrollers and Peripheral Chips	n.a.	n.a.	851	1,135	1,411
Other	n.a.	n.a.	2,602	3,300	3,682
Memories	1,127	1,477	1,425	1,762	1,724
RAMs	n.a.	n.a.	n.a.	n.a.	1,299
ROMs	n.a.	n.a.	n.a.	n.a.	424
Other	n.a.	n.a.	n.a.	n.a.	33
Hybrid	360	428	459	538	592
Discrete Devices	38,283	43,022	46,906	54,075	56,720
Transistors	14,343	15,769	16,722	19,980	22,326
Diodes and Rectifiers	18,702	20,510	22,445	25,828	25,574
Other	5,237	6,743	7,739	8,268	8,821

*The following average annual exchange rates, calculated by the Ministry of Finance, can be used to convert the yen production figures into dollars: 1985, Y238.54; 1966, Y168.52; 1987, Y144.64; 1988, Y128.15; and 1989, Y137.96.

Source: Japan, Ministry of International Trade and Industry, Yearbook of Machinery Statistics.

Table 3A: Japan's Total Exports of Semiconductors, 1985-90

(in millions of yen*)

	1985	1986	1987	1988	1989	Six Months 1990
Integrated Circuits (excl. parts)	Y581,801	Y523,131	Y592,373	Y845,707	Y1,147,781	Y561,673
Packaged	486,169	436,030	500,029	713,817	954,493	465,773
Analog]				106,495	124,772	69,028
Digital Bipolar]				37,471	43,146	22,999
Digital MOS]				533,081	740,108	348,167
Microprocessors]				93,868	122,723	65,709
Logic]				121,894	162,025	87,014
Memories]				317,318	455,360	195,444
Hybrid]				36,771	46,467	25,580
Unpackaged	95,632	87,101	92,344	131,890	193,288	95,900
Parts	n.a.	n.a.	n.a.	107,653	96,118	54,236
Discrete Devices (excl. parts)	114,755	116,137	131,406	168,814	188,894	99,429
Packaged	98,212	98,791	111,112	146,024	162,604	85,225
Transistors	30,429	28,505	33,227	56,931	64,090	35,371
Diodes and Rectifiers	24,247	25,658	30,576	41,663	43,486	22,083
Light-Emitting Diodes				20,419	24,393	11,544
Other]	43,536	44,629	47,309	27,011	30,635	16,226
Unpackaged	16,543	17,346	20,294	22,790	26,290	14,204
Parts	n.a.	n.a.	n.a.	19,978	21,403	11,030
Total Exports (excl. parts)	696,556	639,268	723,779	1,014,521	1,336,675	661,102

Table 3B: Japan's Exports of Semiconductors to the United States, 1985-90

(in millions of yen*)

	1985	1986	1987	1988	1989	Six Months 1990
Integrated Circuits (excl. parts)	Y219,537	Y163,940	Y195,391	Y291,350	Y434,720	Y205,670
Packaged	207,244	154,737	180,980	258,664	381,712	180,169
Analog]				9,547	11,989	7,022
Digital Bipolar]				17,849	18,811	11,626
Digital MOS]				221,300	337,899	153,969
Microprocessors]				22,132	25,136	13,205
Logic]				46,011	58,157	34,309
Memories]				153,157	254,606	106,455
Hybrid]				9,968	13,014	7,552
Unpackaged	12,292	9,203	14,411	32,686	53,007	25,501
Parts	n.a.	n.a.	n.a.	32,608	29,613	15,897
Discrete Devices (excl. parts)	28,788	21,997	21,618	22,562	26,671	15,155
Packaged	26,683	20,108	19,820	20,651	24,762	14,182
Transistors	6,032	5,036	5,261	8,363	10,667	6,517
Diodes and Rectifiers	3,778	3,907	3,630	3,708	4,353	2,047
Light-Emitting Diodes				4,494	5,393	3,285
Other]	16,873	11,164	10,929	4,086	4,348	2,333
Unpackaged	2,106	1,889	1,798	1,911	1,910	973
Parts	n.a.	n.a.	n.a.	2,138	2,440	1,370
Exports to United States (excl. parts)	248,325	185,937	217,008	313,912	461,391	220,824

*The following average annual exchange rates, calculated by the Ministry of Finance, can be used to convert the yen export figures into dollars: 1985, Y240.29; 1986, Y169.99; 1987, Y145.90; 1988, Y128.13; 1989, Y137.34; and January-June 1990, Y150.83.

Source: Japan Tariff Association, Japan Exports and Imports: Commodity by Country.

Table 4A: Japan's Total Imports of Semiconductors, 1985-90

(in millions of yen*)

		1985	1986	1987	1988	1989	Six Months 1990
Integrated Circuits (excl. parts)		Y165,439	Y146,075	Y162,728	Y225,710	Y310,226	Y183,057
Packaged		137,851	118,895	132,780	186,212	252,003	144,680
Analog	]				40,539	55,771	30,013
Digital Bipolar	]				31,537	37,468	23,001
Digital MOS	]				100,230	141,741	83,598
Microprocessors	]				43,712	57,445	32,970
Logic	]				28,841	32,704	22,416
Memories	]				27,677	51,592	28,213
Hybrid	]				13,906	17,023	8,067
Unpackaged		27,588	27,180	29,948	39,498	58,223	38,377
Parts		n.a.	n.a.	n.a.	1,263	1,566	1,026
Discrete Devices (excl. parts)		33,985	26,688	26,355	31,027	41,433	22,928
Transistors	]				13,601	17,592	9,656
Diodes and Rectifiers	]				7,019	11,215	6,198
Light-Emitting Diodes	]				4,009	4,198	2,585
Other	]				6,397	8,428	4,489
Parts		n.a.	n.a.	n.a.	352	765	1,008
Total Imports (excl. parts)		199,424	172,763	189,082	256,737	351,659	205,984

Table 4B: Japan's Imports of Semiconductors from the United States, 1985-90

(in millions of yen*)

		1985	1986	1987	1988	1989	Six Months 1990
Integrated Circuits (excl. parts)		Y125,381	Y110,085	Y119,225	Y166,242	Y220,578	Y133,473
Packaged		102,160	88,179	94,807	134,710	175,232	103,417
Analog	]				21,047	28,680	16,087
Digital Bipolar	]				22,600	25,363	15,452
Digital MOS	]				82,560	110,936	66,935
Microprocessors	]				40,818	54,517	30,667
Logic	]				20,966	19,184	14,180
Memories	]				20,776	37,235	22,089
Hybrid	]				8,503	10,254	4,944
Unpackaged		23,222	21,906	24,418	31,532	45,347	30,056
Parts		n.a.	n.a.	n.a.	962	1,252	813
Discrete Devices (excl. parts)		10,712	7,779	7,304	9,615	12,217	6,227
Transistors	]				4,251	5,136	2,701
Diodes and Rectifiers	]				1,563	2,042	1,065
Light-Emitting Diodes	]				1,107	1,763	867
Other	]				2,694	3,277	1,594
Parts		n.a.	n.a.	n.a.	140	103	33
Imports from United States (excl. parts)		136,093	117,865	126,529	175,857	232,795	139,700

*The following average annual exchange rates, calculated by the Ministry of Finance, can be used to convert the yen import figures into dollars: 1985, Y240.17; 1986, Y170.08; 1987, Y146.01; 1988, Y128.15; 1989, Y137.26; and January-June 1990, Y150.71.

Source: Japan Tariff Association, Japan Exports and Imports: Commodity by Country.

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JEI REPORT

A Two-Part Report: A and B

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Original Peace Team Bill Dies, New Proposal In The Offing

Representatives of the ruling Liberal Democratic Party and noncommunist opposition parties agreed November 8 to scrap a bill that would have authorized the dispatch overseas of Self-Defense Forces personnel to provide nonmilitary support for United Nations-sponsored peacekeeping activities. LDP secretary general Ichiro Ozawa, one of the most aggressive proponents of including SDF personnel as part of the peace cooperation team, noted, however, that while the original bill was scrapped, both the ruling party and certain members of the opposition parties agreed that it behooves Japan to provide financial and personnel support for U.N.-sponsored peacekeeping missions in the Middle East and other potential hot spots.

Speaking to the press following the withdrawal of the measure, Prime Minister Toshiki Kaifu emphasized that cooperation with the United Nations is necessary for Japan. He stated that he expects "better" (meaning, enactable) legislation will be drawn up through consultations between the LDP and members of the political opposition for consideration during the regular Diet session, scheduled to begin around December 10.

Throughout the three weeks of contentious Diet debate on the proposed U.N. Peace Cooperation Law there was speculation that the LDP secretary general, through his forceful advocacy of the unprecedented foreign policy proposal, in fact was positioning himself to assume the reins of power if Mr. Kaifu was unable to get the bill at least through the LDP-dominated lower house. Judging by the ground swell of opposition to the measure (see JEI Report No. 43B, November 9, 1990), however, Mr. Ozawa may lower his profile or soften his rhetoric since his internationalist approach to foreign policy obviously does not yet mesh with the public's conception of Japan's global role.

What could loosen the prime minister's leadership grip is if the United States and other allies criticize the revised proposal as too watered-down, ineffectual and late in coming. Ruling party elders might then decide that a politically stronger leader would be better able to manage the difficult balance between domestic and international pressures.

Barbara Wanner

Japan's Current Account Surplus Plummets

Japan's most recent balance of payments statistics demonstrate the difficulty of having a cake and eating it too. Certainly the data served up by the Bank of Japan looked appetizing enough: the current account surplus dropped 49.7 percent in the July-September quarter compared to a year earlier (see Table 1). The resulting black-ink entry of $7.5 billion was the smallest since

Table 1: Japan's Balance of Payments

(in millions of dollars)

		Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1985		$55,986	$174,015	$118,029	$-5,165	$49,169	$-64,542
1986		92,827	205,591	112,764	-4,932	85,845	-131,461
1987		96,386	224,605	128,219	-5,702	87,015	-136,532
1988		95,012	259,765	164,753	-11,263	79,631	-130,930
1989		76,917	269,570	192,653	-15,526	57,157	-89,246
1988:	I	21,021	59,345	38,324	-1,337	18,421	-15,142
	II	22,448	63,559	41,111	-2,882	18,567	-36,556
	III	23,765	65,989	42,224	-3,623	19,052	-42,214
	IV	27,778	70,872	43,094	-3,421	23,591	-37,018
1989:	I	21,311	66,945	45,634	-3,595	16,064	-5,612
	II	19,794	66,560	46,766	-4,892	14,283	-30,801
	III	19,770	68,157	48,387	-4,023	14,957	-21,559
	IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990:	I	14,393	65,460	51,067	-701	12,305	-16,086
	II	13,614	65,510	51,896	-5,279	7,892	-18,985
	III(p)	17,267	70,329	53,062	-8,043	7,520	-7,011

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1985	$291,338	$237,859	$53,479	$5,484	$4,489	$995
1986	1,346,989	1,253,965	93,024	20,917	13,869	7,048
1987	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1988	1,364,061	1,278,249	85,812	76,560	73,567	2,993
1989	1,683,733	1,589,650	94,083	97,056	79,169	17,887
1988: I	332,047	318,877	13,170	18,901	19,467	-566
II	401,293	374,371	26,922	20,518	20,643	-125
III	333,473	307,635	25,838	25,166	23,425	1,741
IV	297,248	277,366	19,882	11,975	10,032	1,943
1989: I	341,774	327,771	14,003	17,724	17,828	-104
II	487,087	461,996	25,091	21,228	15,120	6,108
III	463,493	437,622	25,871	23,602	18,807	4,795
IV	391,379	362,261	29,118	34,502	27,414	7,088
1990: I	356,393	355,524	869	27,640	22,694	4,946
II	350,993	341,640	9,353	19,972	17,819	2,153
III(p)	331,100	320,195	10,905	18,121	17,662	459

1983 for the third quarter and only half as large as the respected Nomura Research Institute had predicted mere days earlier. Coming on top of an equally good move toward balance in the previous quarter, the resultant double-layered treat could well foretell a 1990 surplus of under $40 billion.

Some Japanese analysts worried, however, that the latest data would leave American critics with a bad taste in their mouth. The trade balance -- the single most important component of the current account surplus -- declined only modestly, a fact reflected in the customs-clearance trade statistics released earlier (see JEI Report No. 41B, October 26, 1990). As a result, the sharp decline in the current account surplus stemmed from dramatic changes in its other two elements, services and transfer payments. The surging imbalance in services easily outstripped a quarterly record established in the previous three-month period. Transfer payments, usually a few hundred million dollars, leaped to $1.7 billion for the quarter on the strength of a $1.1 billion outflow in September, related primarily to Japanese financial contributions to the U.S.-organized funding mechanism in support of allies in the Persian Gulf. In particular, Japanese analysts worried that Americans and others would find surging tourism, the largest component of services, and financial aid, the most important part of transfers, less than ideal ways to shrink Japan's external imbalance.

The decline in Japan's current account surplus highlighted another problem from the U.S. perspective. As Japan's sales and purchases abroad move closer to balance, Japanese investors supply a proportionately lower amount to world capital markets. Japan's third quarter long-term capital outflow of $7 billion, a net figure that includes direct and portfolio investment, was only one-third as large as the comparable figure in 1989.

The drop in the net capital outflow resulted primarily from Japanese institutional investors becoming more cautious about additions to their overseas financial holdings. While net bond purchases in the July-September period were the largest during any quarter this year, they still were less than half the size for the same time a year earlier (see Table 2). Net stock purchases have showed an even sharper falloff this year. Since March Japanese investors generally have added to their overseas holdings in months when the Japanese stock market has risen and reduced them when the market fell; the sharpest sell-off occurred in September when investors unloaded $1 billion worth of foreign stocks.

Taken together, the data in Tables 1 and 2 show a consistent, if not altogether reassuring, pattern. The decline in Japan's current account surplus has coincided with a slowdown in the rate at which Japanese institutional investors are supplying world capital markets with funds. With an increasing number of experts believing that U.S. economic growth has slowed dramatically, the data point to a number of dilemmas facing American policymakers. Declining U.S. economic fortunes suggest that tourism or other foreign expenditures would be welcome; the cost, however, would be a decline in the funds that help finance a recession-swelled budget deficit. In short, the Japanese current account statistics point to some of the difficult choices facing U.S. policymakers. As a result, the decline in Japan's surplus is a tempting treat Americans may have a hard time swallowing.

Douglas Ostrom

Japanese Banks Sneeze, World Catches Cold?

After rising to new heights on the back of the domestic economy's long-running expansion, Japanese banks have stumbled as events have transformed some of their strengths into weaknesses. Major Japanese commercial banks now are expecting profit declines for the year ending March 31, 1991 and have had their credit ratings downgraded recently by independent investment services. While the chances of a major bank failure still are remote, Japanese government and private analysts are concerned that the domestic banks' troubles will make it difficult for them to meet international creditworthiness standards. They also question whether the banks' struggles pose a threat to the health of the entire economy. Moreover, the ripple effect could impact the global economy because of the important role Japanese banks have come to play in world finances.

The banks' woes are extensions of the weaknesses revealed in their business results for FY 1989 (see JEI Report No. 26B, July 6, 1990). Despite increases in operating revenues, the values of stock portfolios eroded and higher operating costs cut profits. This trend is continuing, according to the results for the first half of FY 1990 recently released by four major Japanese commercial banks. Dai-Ichi Kangyo Bank, Ltd., Mitsui Taiyo Kobe Bank, Ltd., Fuji Bank, Ltd. and Sanwa Bank, Ltd. estimate that operating revenues grew about 20 percent over the six months beginning April 1 but that pretax profits were off 40 to 45 percent from the same period in 1989. Based on these six-month results, the four banks projected operating revenue growth of 10 percent

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JEI REPORT

A Two-Part Report: A and B

NO. 45B
November 30, 1990

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Bank Mergers Point To Financial Restructuring In Japan

Japan's financial institutions are restructuring from top to bottom. That seems to be the lesson to be learned from a series of recent merger announcements, regulatory activities and other changes unveiled in November.

The top story involved two banks that rank among the world's biggest, although neither is well-known in the United States. Kyowa Bank, Ltd. and Saitama Bank, Ltd. announced November 13 that they will merge effective April 1, 1991. The new bank will rank as the eighth largest in Japan as measured by loan volume. By itself Kyowa had ranked ninth, just behind Bank of Tokyo, Ltd. The new bank will be the 19th largest in the world.

The merger of the two, which both belong to the select group of 12 nationwide commercial banks known in Japan as city banks, comes on the heels of the April 1, 1990 merger between two other city banks, Mitsui Bank, Ltd. and Taiyo Kobe Bank, Ltd. (see JEI Report No. 35B, September 15, 1989). (Seven trust banks and three long-term credit banks complete the top tier of private

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STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1988	1989	January-September 1989	January-September 1990	July 1990	August 1990	September 1990
Japan's Balance of Payments							
Trade Balance	$95,012	$76,917	$60,875	$45,274*	$5,416*	$4,121*	$7,730*
Exports (f.o.b.)	259,765	269,570	201,662	201,299*	23,333*	21,894*	25,102*
Imports (f.o.b.)	164,753	192,653	140,787	156,025*	17,917*	17,773*	17,372*
Current Account Balance	79,631	57,157	45,304	27,717*	2,019*	942*	4,559*
Long-Term Capital (net)	-130,930	-89,246	-57,972	-42,082*	-7,895*	-4,835*	5,719*
Overall Balance	-28,982	-33,286	-3,999	-10,100	-12,732	-150	10,785
International Reserves (end of period)	97,662	84,895	86,117	75,323	74,585	75,315	75,323
Japan's Customs Clearance Trade							
Trade Balance	77,563	64,328	49,941	41,531	5,387	3,465	6,919
Exports (f.o.b.)	264,917	275,175	205,423	206,207	23,949	22,442	25,854
Cars	38,671	38,804	29,366	29,928	3,303	3,068	3,798
Steel	15,322	14,789	11,264	8,991	1,064	1,042	1,003
Imports (c.i.f.)	187,354	210,847	155,482	164,676	18,562	18,977	18,935
Crude Oil	18,852	21,544	15,402	18,316	1,541	1,859	2,541
Manufactured Products	91,838	106,111	77,982	85,026	10,089	10,009	9,748
Japan-U.S. Trade							
Trade Balance	47,597	44,943	33,716	27,253	3,073	2,832	4,317
Exports (f.o.b.)	89,634	93,189	69,841	65,542	7,531	7,122	8,288
Imports (c.i.f.)	42,037	48,246	36,126	38,289	4,458	4,290	3,971
Yen-Dollar Exchange Rate (average for period)	Y128.15	Y137.96	Y136.27	Y149.46	Y149.28	Y147.42	Y138.99
U.S. Trade							
Trade Balance	-118,526	-109,399	-80,179	-72,065*	-10,510	-10,515	-9,658*
Exports (f.a.s.)	322,426	363,812	270,902	291,816*	30,729	31,664	31,317*
Imports (Customs)	440,952	473,211	351,081	363,881*	41,238	42,179	40,975*
U.S.-Japan Trade							
Trade Balance	-51,793	-49,059	-36,596	-29,390*	-2,966	-3,780	-3,055*
Exports (f.a.s.)	37,725	44,494	33,132	35,613*	4,220	3,918	3,992*
Imports (Customs)	89,518	93,553	69,728	65,004*	7,186	7,698	7,047*

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1988	1989	January-September 1989	January-September 1990	July 1990	August 1990	September 1990
Discount Rate (end of period)	2.5%	4.25%	3.25%	6.0%	5.25%	6.0%	6.0%
Outstanding Money Supply	11.2%	9.9%	9.9%	12.2%	12.2%	11.9%	12.0%
Industrial Production	9.5%	6.1%	6.9%	3.7%	7.0%	5.5%	5.3%
Manufacturing Operating Rate	5.9%	2.2%	2.9%	1.6%	4.3%	3.1%	2.5%
Number of Bankruptcies	-20.0%	-28.4%	-25.8%	-20.6%	-12.5%	-8.5%	-6.2%
Residential Construction Starts	0.6%	-1.3%	-2.5%	4.1%	6.3%	-0.1%	5.2%
Job Openings to Applications (ratio)	1.01	1.26	1.24	1.40	1.45	1.45	1.43
Nominal Wages	3.8%	4.7%	4.3%	5.1%	6.0%	3.4%	4.5%
Manufacturing Labor Productivity	11.5%	6.2%	8.9%*	2.2%*	n.a.	n.a.	n.a.
Wholesale Prices	-1.0%	2.5%	2.2%	2.1%	0.8%	1.1%	0.9%
Consumer Prices	0.7%	2.3%	2.2%	2.9%	2.3%	2.9%	3.0%
Yen-Based Export Prices	-2.2%	4.4%	3.9%	4.3%	2.3%	2.5%	-2.3%
Yen-Based Import Prices	-4.6%	7.7%	5.8%	8.0%	1.9%	3.6%	6.1%

*Through June of each year only.

For Japan's latest GNP figures, see JEI Report No. 37B, September 28, 1990.

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JAPAN · ECONOMIC · INSTITUTE
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REPORT

A Two-Part Report: A and B

NO. 46A December 7, 1990

AN ECONOMIC VIEW OF JAPAN'S CHANGING DEMOGRAPHICS: NOT ENOUGH BABIES?

Summary

Japan's demographic composition is changing very quickly by historical standards. The rapid increase in its elderly population has significant implications for the savings rate as well as government-financed social welfare programs and tax revenues. Equally important, Japanese women are having fewer babies; that could affect the ability of tomorrow's work force to support the increased ranks of elderly.

If present trends continue, the labor force in Japan is likely to begin shrinking early in the next century at the latest and the population to decline within the next 25 years. One consequence is likely to be slower economic growth than otherwise and increased demand for capital in the face of a possible slowing of the savings rate. As a result, the outflow of capital from Japan could decline, with implications for interest rates in the United States.

The "birth dearth" has become a matter of national debate in Japan. Some argue for countermeasures. Others suggest that the birthrate is not extraordinarily low compared to other industrialized countries and may even carry many benefits. These analysts argue, in essense, that no problem exists.

Introduction

Mark Twain once noted in a flight of fancy that, given then current trends, the lower Mississippi River eventually would be only a mile and three-quarters long. Recent statistics on population trends in Japan would confirm the American humorist's view of extrapolation. A Japanese publication this year estimated that the so-called birth dearth in Japan, if unchecked, would lead to a population of 45,000 by the year 3000, a 99.96 percent reduction.

For Japanese policymakers, however, the phenomenon is no laughing matter. As in many other countries, a growing population frequently is seen as a source of national vitality. Japanese leaders from Prime Minister Toshiki Kaifu on down have called for a study of national countermeasures. The source of their concern is encapsulated in a single statistic, the release of which led to the "1.57 shokku" earlier this year. The figure, technically known as the total fertility rate, refers to the number of children a woman is expected to bear over her lifetime. A value of 2.1 is considered the long-run break-even point to sustain a nation's population unless there is immigration. Of course, a relatively young population can grow for decades even with a figure below 2.1, but a country's population eventually will shrink if the figure approaches 2 children per woman. Hence, the fear in Japan is that its population, which still is growing in absolute numbers, eventually will level off and then decline in size.

Japan's fertility rate has been below 2.1 for nearly 20 years so 1989's suboptimal figure came as no surprise. What shook Japanese leaders was the relatively big decline (5.4 percent) in the number at a time when one of the country's major economic concerns is a long-run shortage of labor. Japan's fertility rate is lower than that of most other industrial nations (see Table 1). Obviously, a falling fertility rate suggests that a stable -- or declining -- population will arrive sooner rather than later. The Ministry of Health and Welfare's latest midrange estimate (made in 1986) indicated a population of

Table 1: Fertility Rates in Industrial Countries, 1965-89

(expected births per woman*)

	1965	1970	1975	1980	1985	1986	1987	1988	1989
Japan	2.14	2.13	1.91	1.75	1.76	1.72	1.69	1.66	1.57
United States	2.93	2.48	1.77	1.84	1.84	1.84	1.87	1.93	n.a.
Sweden	2.42	1.94	1.78	1.68	1.73	1.79	1.84	1.96	2.02
Great Britain	2.85	2.45	1.81	1.89	1.80	1.78	1.81	1.83	n.a.
France	2.84	2.47	1.93	1.95	1.82	1.84	1.82	1.82	n.a.
West Germany	2.50	2.02	1.45	1.45	1.28	1.35	1.38	1.40	n.a.

*The average number of births that a woman would have in her lifetime if, at each year of age, she experienced the birthrates occurring in the specified year.

Sources: Ministry of Health and Welfare (Japan), National Center for Health Statistics and Department of Commerce, Census Bureau (United States), United Nations, Council of Europe and other national sources.

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135.9 million in the year 2015 (see Table 2). This year Nihon University Population Research Center predicted the population would peak in 2012 at 131.5 million. September estimates by Sanwa Bank, Ltd. put the peak even earlier -- 126.9 million in 2005 -- based on the most recent fertility rate. (As of October 1, 1990 Japan's population was estimated at 123.7 million.) Judging by these various forecasts, Japan could be only 15 years away from a declining population and perhaps even closer should the fertility rate drop further.

Table 2: Japan's Past and Projected Population, 1920-2025

October 1	Population (thousands)	Age Distribution 0-14 Years	 15-64 Years	 65 and Over
1920	55,963	36.5%	58.2%	5.3%
1930	64,450	36.6	58.6	4.8
1940	71,933	36.7	58.5	4.8
1950	83,200	35.4	59.7	4.9
1955	89,276	33.4	61.3	5.3
1960	93,419	30.0	64.3	5.7
1965	98,275	25.6	68.1	6.3
1970	103,720	23.9	69.0	7.1
1975	111,940	24.3	67.8	7.9
1980	117,060	23.5	67.4	9.1
1985	121,049	21.6	68.2	10.2
1988	122,783	19.5	69.2	11.2
1989	123,255	18.8	69.6	11.6
1990	124,225	18.6	69.4	11.9
1995	127,565	17.5	68.3	14.1
2000	131,192	18.0	65.8	16.3
2005	134,247	18.7	63.2	18.0
2010	135,823	18.6	61.4	20.0
2015	135,938	17.6	59.9	22.5
2020	135,304	16.5	59.9	23.6
2025	134,642	16.4	60.2	23.4

Note: Figures for 1920-85 are from the national census conducted at five-year intervals. Figures for 1988 and 1989 are estimates. Figures for 1990-2025 are from Ministry of Health and Welfare, "Future Population Projection for Japan," December 1986. By comparison, the Management and Coordination Agency estimated the October 1990 population at 123,680,000.

Sources: Management and Coordination Agency and Ministry of Health and Welfare

Japan's experience, however, may not be unique among industrial nations. Table 1 highlights both the similarities and the differences in fertility rates. While Japan's fertility rate has been consistently among the lowest, rates declined faster elsewhere during the 1970s with the result that fertility levels were very similar among most industrial nations by 1985. Since then, however, rates have risen in the United States, Sweden, Great Britain and West Germany, while those in Japan have continued declining. (The French figure has remained fairly stable.) Furthermore, some nations -- such as the United States -- experience significant net immigration, creating a potential divergence between fertility rates and long-run population trends.

Older Japanese can remember a very different environment than that suggested by Table 1. In 1950 the fertility rate was 3.65, which, when combined with the most recent figures, suggests that Japanese families in the future are likely to have fewer than half as many children as they did at the dawn of the postwar era. Japan's population increase of 0.38 percent in 1989 was the smallest peacetime rate of growth ever recorded in data going back to 1872; the 1.2 million live births were the lowest number in the 20th century. During the 1920s and the 1930s, when the population was little more than half the present size, live births consistently were above 2 million per year.

The plummeting birthrate is at best only half the demographic equation affecting Japan. Although that country currently has a population slightly younger than the United States, it is aging very rapidly. Fewer babies than expected obviously pulls up the average age, but Japanese also are living longer and experiencing the delayed effect of high birthrates generations ago. Nihon Keizai Kyoiku Senta (Center for Economics Education) has compared the data from Table 2 with other national data to make this point. For example, Japan's over-65 population reached 7.1 percent of the total in 1970, 25 years after the U.S. population had the same characteristic. In 1995, however, that age group will represent 14.1 percent of the population, 15 years before the United States. (As noted previously, the U.S. composition is affected by immigration.)

Putting the same argument another way, 10.2 percent of the population in 1985 was over 65; conservative Ministry of Health and Welfare estimates put the share at 23.6 percent in 2020. By contrast, 11.9 percent of the U.S. population was over 65 in 1985; by 2020 this figure is predicted to rise to 17.3 percent. According to the center's data for the six nations listed in Table 1, between 1985 and the turn of the century Japan will move from having the youngest average age to being second only to Sweden in the size of its older population; by 2020 it will pass Sweden on this basis.[1] (For further details of Japan's aging population, see JEI Report No. 12A, March 27, 1987. For a more recent discussion that concentrates on the pension dimension of the phenomenon, see JEI Report No. 21A, May 25, 1990.)

Japan obviously can do little about the increasing ranks of elderly. In many ways, in fact, the ability of many Japanese to live to an advanced age is a tribute to the high standard of living that Japan has obtained in a relatively short time. Japanese now have the longest life expectancy on earth, with Japanese girls born in 1989 expected to live 81.8 years on average and boys 75.9 years. A Japanese man at age 60 can look forward to nearly 20 years of retirement should he leave the labor force at that age. With the government picking up at least part of the health care tab of maintaining people in old age, having fewer young people to replenish the ranks of those leaving the labor force obviously increases the tax burden on the working population. Hence, for strictly budgetary reasons, some Tokyo officials have advocated seeking ways to boost the birthrate.

[1] Nihon Keizai Kyoiku Senta, Koreika Shakai to Kokumin Futanritsu no Hanashi (Tokyo: Keizai Kyoiku Senta, September 1990), p. 3.

Why Has Japan's Birthrate Been So Low?

Increasing Japan's birthrate first requires understanding why it is lower than elsewhere and why it has trended down for the last 20 years; neither is an easy proposition. Finance Minister Ryutaro Hashimoto got himself in hot water with women's groups and editorialists at the New York Times earlier this year when he was reported to have suggested at a cabinet meeting that "the source of the problem is the spread of higher education among women." Despite the protests of Japanese women's groups, the argument is not totally without merit as a partial explanation.[2] Higher levels of education naturally lead to higher income than otherwise, thereby increasing the money that a Japanese woman would forgo were she to have children and leave the labor force for a prolonged period. Some Japanese families, like their American counterparts, could be expected to opt for income over children. Of course, few people would suggest seriously that the "solution" is less education for Japanese women.

As in America, however, the educated woman in pursuit of a career finds that improved child-care facilities ease the compromise between children and career. A Ministry of Health and Welfare survey that asked women why they were having so few babies found that the largest number of respondents, 36.6 percent of the total, gave the high cost of child care as a reason. Other reasons given by women in the same poll illustrate further aspects of the problem. The high cost of each child's education was given as a factor by 29.6 percent, the physical and the emotional burdens of child-rearing by 25.3 percent, the lack of household space by 15.9 percent and harm to careers by 14.4 percent.

For Americans these explanations resonate with widely held perceptions of Japanese life. Compared to this country, Japanese schooling -- particularly secondary education -- appears expensive, involving, for example, extra payments for juku (extra schooling to pass examinations or learn what would be elective subjects in the United States). Tuition payments past the ninth grade or for private schools and the psychological stress to parent and child as a result of demanding study schedules also carry costs. (For details on Japan's education system and a discussion of reform proposals, see JEI Report No. 45A, November 30, 1990.) Sensing the connection between the cost of kindergarten and the low birthrate, officials in northern Japan's Akita prefecture announced in November they would create a new program to ease the cost of kindergarten for a couple's third child. (Akita lost an estimated 1.8 percent of its population between 1980 and 1989, the largest percentage decline among Japan's 47 prefectures.)

Japanese housing undeniably is cramped to the point of affecting lifestyles significantly. (For details see JEI Report No. 30A, August 4, 1989.) Additionally, parks and playgrounds are scarce, particularly in urban areas. Transportation and other public facilities often are poorly suited to families with young children.

[2] At least one Japanese specialist, Noriko Tsuya, an American-educated sociologist, acknowledges the importance of this factor, albeit indirectly, in an article in a popular Japanese business weekly. To her, however, higher education for women does not constitute a "problem." See Noriko Tsuya, "Kodomo-o Umu Umanai-wa Kojin no Sentaku," Ekonomisuto, August 7, 1990, p. 50.

Significantly longer working hours, commuting times and corporate socializing for Japanese workers compared to their counterparts in other industrial countries reduce the amount of time couples are together, with obvious implications. In addition, the parent working under these conditions -- typically the father -- has a proportionately reduced role as a care-giver, increasing the burden on the mother. These same time requirements obviously make it more difficult for a young mother to work outside the home herself, absent a helpful spouse. One of Japan's most influential business leaders, Eiji Suzuki, the head of Nikkeiren (Japan Federation of Employers' Associations), has linked conditions of work and the low birthrate, arguing, among other things, for "a desperate exploration by both the corporation and the individual to prepare an environment in which women can bring up children."

Compared to their counterparts in other industrial countries, Japanese women are far more likely to leave the labor force for a prolonged period after they give birth. In addition to the lack or expense of child-care facilities, young couples have to contend with societal views that discourage mothers with young children from working. Some women no doubt respond to this problem by remaining childless longer.

Of course, the joy of having children, if the burdens can be overcome, is as great in Japan as elsewhere. In addition, Japanese parents traditionally have been able to anticipate a concrete benefit: care in old age from a child or child's spouse with whom one lives. However, this expectation probably is diminishing; increasing numbers of elderly either are living with only their spouse or alone. The number of people over 60 living with their married or unmarried children declined from 67 percent in 1980 to 59 percent in 1988, the latest year for which Health and Welfare Ministry data are available. Similar data spanning longer time periods suggest that the trend away from extended families living together has been under way for decades.

Changing educational levels and career paths may interact with another pattern that many experts identify as a primary cause of lower birthrates in other industrial countries. Japanese couples are getting married later (see Table 3). The average age of marriage for Japanese women increased from 24.5 in 1974 to 25.8 in 1989; for men the corresponding figures were 26.8 and 28.5. At a minimum, later marriage postpones population growth. In 1950 the average

Table 3: Marital Status of Young Women in Industrial Countries, 1950-80

(percentage of women between 20 and 24 who are unmarried)

	1950	1960	1970	1980
Japan	55.2%	68.3%	71.7%	77.7%
United States	32.3	28.4	36.3	51.3
Sweden	59.7	57.5	60.0	83.3
Great Britain	52.5	42.0	41.2	53.7
France	49.9	54.3	50.6	51.4
West Germany	67.6	54.6	41.6	60.1

Source: Ministry of Health and Welfare

age of a mother having a first child was 24.4 years; by 1988 the age had risen to 26.9 years. In addition, fewer years of marriage during the main childbearing years may reduce the average number of children, especially if, as is the case in Japan, it is rare for a child to be born illegitimately.[3]

Taken together, these factors suggest that, on objective criteria alone, Japan could be expected to have a relatively low birthrate. In other words, Japanese families well may have made a rational calculation of the costs and the benefits of having children. From the foregoing, it is clear that the costs (for example, forgone income, educational and child-rearing expenses and the need for more expensive housing) generally are high compared to other industrial nations; moreover, they have risen over the past 20 years. Conversely, some of the benefits, such as the possibility of receiving care in old age from one's child or child's spouse, have declined in the postwar period. Two offsetting factors are higher real incomes, which should make children more affordable, and longer lives, which make having an old-age care-giver a more attractive option -- if the elderly can get their child's family to oblige. Countermeasures, if deemed necessary, would have to alter family cost-benefit calculations.

Consequences of Japan's Falling Birthrate

Individual families are not the only ones to save money from having fewer children. The need diminishes for educational facilities, for example. Japan has been reducing the number of kindergartens since 1985. As the birthrate has continued to fall, Education Ministry officials have scaled back their projections for school needs at all levels. One estimate put the education savings at about 1 percent of gross domestic product by the year 2000 as compared to the requirements in 1980.[4]

Given Japan's increasing numbers of elderly, the birth dearth has had a positive economic effect up to now. Social obligations, governmental or personal, to the elderly can be handled more easily if fewer children compete for such resources. To date, the reduced number of children has more than offset the increased number of elderly, alleviating the net burden on the working population (Table 2). In fact, the 15-64 age group, which roughly corresponds to the potential labor force, stood at an all-time high as a percentage of the population in 1989. To put the argument differently, Japan's dependency ratio (those below age 15 or 65 and over as a percentage of the population) was at an historic low.

The dependency ratio has fallen partly because the group between 15 and 65 has grown substantially in recent years. As indicated in Table 1, Japan had relatively high birthrates in the 1970s, especially between 1971 and 1974, a period when the phenomenon was called the second baby boom. (The first baby boom in Japan lasted from 1947 to 1949.) Since 1979 Japan's population of 18-year-olds has increased dramatically, going from 1,580,000 to 1,930,000 in 1989, a jump of 22.2 percent. Even though many delay their entry into the labor force to pursue further education, their sheer numbers have helped keep the growth of the labor force high and the dependency ratio low.

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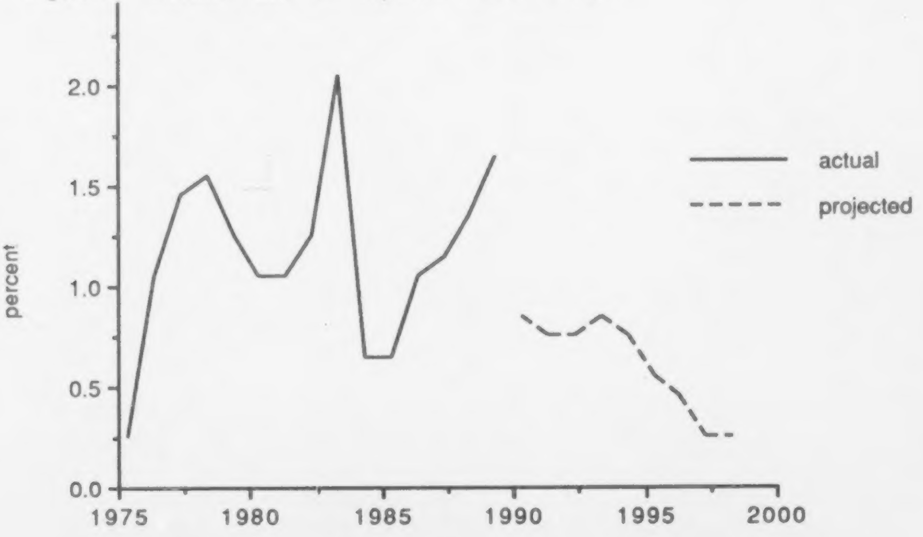
[3] Abortion does not appear to be a factor in Japan's low birthrate, widespread impressions notwithstanding. According to the New York City-based Alan Guttmacher Institute, Japan reported 18.6 abortions per 1,000 women of childbearing age in 1987, the latest year for which comprehensive data are available; the comparable figure for the United States was 26.9.

[4] Peter Heller et. al., Aging and the Social Expenditure in the Major Industrial Countries: 1980-2025 (Occasional Paper 47) (Washington: International Monetary Fund, September 1986), Table 14.

Delayed childbirth probably is another factor that has swelled the size of the labor force. Young women are likely to remain employed if they do not have children, other factors equal. The causality also could be reversed -- high labor force participation rates and greater career opportunities for women are likely to lead to delayed marriage and childbirth. For whatever reason, young women are far more likely to work outside the home than just a few years ago. The increased participation rate of women between 20 and 29 in the labor force added over 200,000 people to the total between 1984 and 1988 and accounted for more than 9 percent of the growth of the labor force, based on Management and Coordination Agency data. (This number is in addition to those who would have been added had the participation rate remained at 1984 levels.) Hence, the very factor that may reduce the size of the labor force -- fewer babies -- also may be swelling it.

However, the long run may be about to catch up with Japan. The lower birthrates of recent years will begin shrinking the pool of 18-year-olds after 1992, when their number is expected to peak at 2.1 million. By the year 2000 the number in this age group will shrink 26.3 percent from its peak to 1.5 million. Depending on participation rates, the labor force after the mid-1990s either will grow much more slowly or decline. Figure 1 shows the estimates made

Figure 1: **Growth rate of Japan's Labor Force**



Note: The sharp drop in 1984 and 1985 was partly from an unusually low number of births in 1966, which, according to the Chinese zodiac; was an usually unlucky year that occurs at 60-year intervals.

Source: Management and Coordination Agency (actual figures), and Ministry of Health and Welfare (estimates for 1990-98), as cited in Rodo Hakusho (1990 Labor White Paper) by the Health and Welfare Ministry in 1986 along with the actual rates of growth in the labor force through 1989. As the figures hint, the labor force can grow faster than expected if the participation rate of the population rises. The increasing shortage of labor in Japan already may have induced more housewives, students and older persons to enter or remain in the labor force in the 1987-89 period than otherwise would have been true. (As an indication of the labor market tightness, the job-opening ratio stood at 1.25 in 1989, the highest average annual rate since 1973. During the first half of the 1980s the rate averaged only 0.66.)

While the Health and Welfare Ministry's data in Figure 1 show a slowing but still positive rate of growth in the labor force during the latter part of this decade, other data paint a different picture. Sanwa Bank, for example, believes that the labor force will hit a peak of 61.3 million in 1996 and then begin declining at an annual rate of 0.6 percent, reaching 51.6 million by 2025.

If Japan's labor force grows more slowly, so will its economy, other factors equal. A shrinking labor pool could be offset by increased hours per worker, but official policy and worker preference argues for just the opposite trend: diminishing hours per worker. Recent Ministry of Labor calculations suggest that the growth of labor inputs (the size of the labor force and hours per worker) has accounted for about half the growth in the Japanese economy in recent years (see Table 4). If so, a hypothetically stable labor force would result in Japan's gross national product growing about 2 percentage points less rapidly toward the end of this decade than it did at the beginning, other factors equal.

Of course, the composition of the labor force also matters. Like the population, it is aging fairly rapidly (see Figure 2). While the decline in

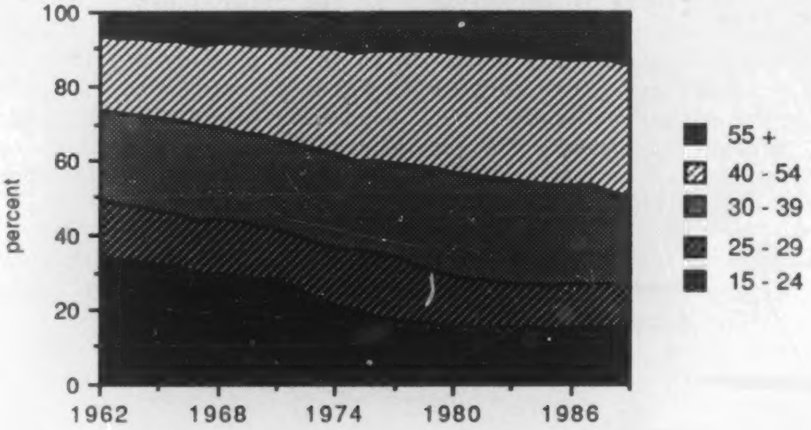
Table 4: Contributions of Labor and Capital to Japan's Real Economic Growth, 1965-88

	Real GNP Growth Rate		Contribution*	
	Actual	Simulated	Capital Stock	Labor Inputs
1965-73	9.8%	11.2%	7.8%	3.4%
1973-75	0.6	-1.2	3.5	-4.7
1975-77	5.1	7.2	2.7	4.6
1977-80	4.9	4.2	2.3	1.9
1980-83	3.3	4.3	2.1	2.3
1983-85	5.0	3.6	2.8	0.9
1985-86	2.5	3.1	1.9	1.2
1986-88	5.2	4.0	2.0	2.0

*Based on simulated GNP growth rate, the hypothetical growth rate that is based primarily on the counterfactual assumption that capital and labor inputs are the only determinants of GNP growth and are perfectly measured. Therefore, differences between actual and simulated GNP arise primarily from measurement error, changing factor productivities and factors other than capital and labor.

Source: Ministry of Labor, Rodo Hakusho (Tokyo: Nihon Rodo Kenkyu Kiko, 1990), p. 415.

Figure 2: **Percentage of Japanese Workforce by Age**



Source: Ministry of Labor

very young workers has leveled off in recent years, the ranks of older workers have continued to increase significantly as a percentage of the labor force and in absolute numbers. This is another reason for believing that the labor force will decline in absolute size; these oldsters cannot go on forever. They can give it a good try, however; older Japanese workers are far more likely to work than their counterparts in other industrial countries or even those in South Korea.[5]

Up to a point older workers are likely to be more productive than their younger counterparts, who lack the same on-the-job training. However, blue-collar workers may hit their peak productivity before white-collar workers. This argument suggests that the aging of the work force may correlate with an increase in productivity for white-collar workers compared to their blue-collar colleagues.

The figures in Table 4 hint at another possibility regarding the growth and the composition of the Japanese economy. Certainly, a smaller labor force by the early part of the next century at the latest is likely to result in upward wage and salary pressure. Such pressure may create incentives for Japanese employers to use their labor force -- including women workers who made up 40.1 percent of the total as of 1988 -- far more productively. (For details of how Japanese women participate in the labor force, see JEI Report No. 18A, May 5, 1989.) Higher wages will make the substitution of capital for labor more likely. While the visions held by some experts of robots replacing a diminishing supply of young workers for manual jobs may be farfetched, capital accumulation clearly can be a powerful means of maintaining economic growth in the face of a slowly growing, or even shrinking, labor force. The figures in

[5] For data on this phenomenon as well as a discussion of employment practices regarding older workers, see Marcus E. Rebick, "After-Lifetime Employment in Japan," A paper presented to Japan Economic Seminar, November 16, 1990. Rebick's data seem to suggest that a simple extension of the retirement age in Japan would do little to reverse the decline in the growth of the labor force since, after retirement, workers often move to a different job.

Table 4 suggest that, if Japanese businesses were to maintain spending on plant and equipment at levels sufficient to sustain the growth of the capital stock at 1986-88 rates, real economic growth could exceed 2 percent a year even if the labor force stabilized in size.

As Japan's population ages, social demands on the capital market are likely in addition to demands resulting from corporate incentives to increase the plant and equipment spending. One researcher has estimated, for example, that demographic changes could add 5.41 percentage points to pension expenditures and 0.67 point to health expenditures as a percentage of GDP by the year 2000 compared to 1980.[6]

Such demands for capital could pull up interest rates, possibly diverting to the home market what in earlier times would have been overseas capital flows. Such a scenario raises an additional question: Will Japan's savings suffice to finance such investment? A great deal will depend on the other tail of the demographic distribution: the elderly. If the aged dissave and require increased government transfer payments as well, then a declining national savings rate could collide with a rising demand for investment. However, an increasing number of experts believe that tomorrow's elderly Japanese will not dissave significantly but will opt to maintain their savings in order to leave a bequest to their heirs. If so, the savings-investment crunch could be avoided or minimized.

Conclusion

Should Japan's outbound capital flows diminish significantly, Americans will feel the impact. Absent major further progress on reducing the federal budget deficit or an unlikely spurt in personal savings, the United States is likely to remain a net importer of capital, with Japan being the largest supplier. (Payments to America's own aging population will create new demands on capital markets early in the next century.) Should Japan's capital requirements rise considerably over the next few years as a result of demographic factors or for other reasons, U.S. interest rates would be nudged higher than otherwise.

Paul Masson of the International Monetary Fund and Ralph Tryon of the Federal Reserve Board have used an econometric model to evaluate the effects of demographic changes in the United States, Japan and other members of the Group of Seven industrial countries, taking account of the interaction of demographic changes in one country on the others (see Table 5). The effects on Japan are dramatic. Compared to the baseline year of 1995, Japan's current account by the year 2000 will be reduced by 2.5 percent of GNP. Assuming that the current account would not otherwise grow from the 2 percent of GNP it equaled in 1989, Masson and Tryon's figures imply a substantial deficit in Japan's current account by the year 2000 arising from demographic factors. In addition, real interest rates first will dip, then rise because of demographic shifts; real GNP will be larger through the year 2000, then progressively smaller.[7]

[6] Heller, op. cit., Table 14.

[7] Paul R. Masson and Ralph W. Tryon, "Macroeconomic Effects of Projected Population Aging in Industrial Countries," IMF Staff Papers, September 1990, pp. 473-474.

Table 5: Effects of Demographic Shifts in Japan and the United States, 2000-2025*

(deviations from 1995 baseline demographic composition)

	2000	2005	2010	2015	2020	2025
	(in percent)					
Japan						
Real GNP	0.4%	-3.1%	-6.4%	-9.5%	-11.8%	-13.2%
Real Interest Rate	-3.3	-1.2	0.6	2.5	4.1	4.8
Capital Stock per Worker	5.1	9.1	10.2	8.3	4.3	-0.5
United States						
Real GNP	-0.1	3.2	4.9	4.7	2.5	-0.1
Real Interest Rate	0.1	-1.1	-1.4	-0.5	1.1	2.9
Capital Stock per Worker	-2.2	-3.1	-1.7	1.2	3.7	4.3
	(as percent of GNP)					
Japan: Current Account	-2.5%	-3.8%	-4.4%	-4.5%	-4.4%	-4.0%
United States: Current Account	1.1	2.5	3.1	3.0	2.8	2.7

*Combined effects of changes in consumption, production and government expenditures resulting from demographic changes in the United States, Japan, West Germany, France, Italy, the United Kingdom and Canada.

Source: Paul R. Masson and Ralph W. Tryon, "Macroeconomic Effects of Projected Population Aging in Industrial Countries," IMF Staff Papers (September 1990), pp. 473-74.

Beyond the possible effects on capital flows, Japan's worsening labor shortage could have other international repercussions not captured in the Masson-Tryon model. If labor is scarce in Japan, economic growth could slow despite a possible increase in capital stock, reducing Japan's global presence compared with the alternative. Yet other means of dealing with the "problem" -- if ultimately that is what it is judged to be -- would raise Japan's global presence. For example, Japanese companies could make increased use of foreign workers, either in Japan through legal or illegal means, or they could accelerate the establishment of overseas subsidiaries.

Many of the ways of adjusting to a relatively small labor force in Japan already are emerging. For example, illegal workers accounted for 5 to 10 percent of the growth of the Japanese labor force in 1989, based on unofficial estimates of the growth of the illegal work force. Plant and equipment spending levels have been at very high levels in 1990, as they were in 1989. Last year, for example, business investment accounted for 19.4 percent of GNP; in the April-June period, the most recent quarter for which data are available, the figure came to 20.8 percent. By comparison, in 1983, the same investment ratio was 14.6 percent.

Many factors, however, remain unknown. Politicians, for example, have yet to tip their hands as to possible countermeasures for the low birthrate. With Japan's early 21st century potential work force already born, the demographic handwriting already is on the wall. Exactly how all the affected groups -- Japanese couples, politicians and companies -- will choose to react remains to be seen.

For further information, contact Douglas Ostrom.

Shawn Guse provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

NO. 46B
December 7, 1990

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Supplemental Budget Takes Shape

Accelerating the supplemental budget process to meet Japan's Persian Gulf commitments, the cabinet of Prime Minister Toshiki Kaifu November 30 approved a FY 1990 supplemental spending package of just under Y2.3 trillion ($17 billion at Y135=$1.00), thus paving the way for Diet action on the spending bill before the end of this year. The Ministry of Finance also is rushing to compile a spending plan for next fiscal year but faces several controversial issues.

The FY 1990 supplemental spending package includes Y627.8 billion ($4.7 billion) for disaster relief and reconstruction and Y459.3 billion ($3.4 billion) for government employee salary hikes. About Y190 billion ($1.4 billion) has been penciled in for Persian Gulf-related measures, including Y130 billion ($963 million) for the multinational military forces in Saudi Arabia; Y20 billion ($148.1 million) in low-interest loans to Egypt, Turkey and Jordan, the countries most affected by the international economic embargo of Iraq and Kuwait; and a Y40 billion ($296.3 million) addition to the government's trade insurance fund to compensate for the increased risk of Middle East transactions. The proposed package also contains Y56.8 billion ($420.7 million) to political heat has all but disappeared on this issue, the parties remain far apart on how to distribute the burden of the tax more fairly, especially with regard to small businesses, a politically powerful lobby. The prospect of a new property tax also promises to generate political fireworks (see JEI Report No. 45B, November 30, 1990). The LDP's Tax System Research Council November 30 discussed two alternatives for large land holdings: 0.3 percent of the assessed value of property worth more than Y500 million ($3.7 million) or 0.5 percent for real estate valued at Y1 billion ($7.4 million) or more. The tax would become effective April 1, 1992 and be based on annual assessments. Thanks to a large number of exemptions -- for small residential holdings, government-owned land and property used for the public benefit (for example, hospitals) -- the proposed tax would fall on only about 200,000 to 300,000 taxpayers, compared to the approximately 27 million individuals or businesses that currently pay the fixed assets tax. The government will have to overcome strong resistance from corporations with large real estate holdings, however, before enacting such reforms.

Jon Choy

Japanese Firms Struggle With Financial Changes

For some Japanese companies 1990 is the best of times, with profits rising amid the continuing domestic economic expansion, which now is near a postwar record for its duration. But for an increasing number of firms, the worst of times appears close, particularly for companies exposed to the Japanese real estate or stock markets. Itoman & Co., Ltd. exemplifies this group of businesses. A medium-sized trading company traditionally specializing in textiles, the firm is a second-tier member of the Sumitomo keiretsu, although non-Sumitomo firms remain large shareholders and lenders. (For details of Japan's keiretsu, see JEI Report No. 2A, January 12, 1990.) In recent years under the guidance of corporate leaders closely connected to Sumitomo Bank, Ltd., the company increasingly ventured into real estate.

This fall Itoman's problems became apparent. Rising interest rates increased the firm's costs dramatically; a softening real estate market, partly a consequence of the high cost of money, compounded its difficulties. The October 7 resignation of Sumitomo Bank chairman Ichiro Isoda gave Itoman's problems a higher profile even though Mr. Isoda's resignation was said to be unrelated. At the time of his resignation, Itoman already was getting special attention. By mid-November Sumitomo Bank and Itoman appeared to have settled on a rescue plan that called for Itoman to scale back dramatically its debt levels by reducing the level of loans outstanding to smaller, affiliated real estate concerns. The bank also agreed to shoulder some of the debt of one of Itoman's real estate subsidiaries. As of early December, however, Itoman's prospects remained unclear, with new problems surfacing in the press almost daily.

Itoman's rescue, if ultimately successful, will be small potatoes for the Sumitomo Group, which has a reputation for having more than its share of problem companies. The group's most spectacular corporate restructuring was its 1979-80 rescue of Mazda Motor Corp., then known as Toyo Kogyo Co., Ltd. Reportedly on the brink of bankruptcy at that time, the company had recovered fully by the mid-1980s.

The Itoman and Mazda cases seem to suggest that large Japanese companies, unlike their American counterparts, are able to avoid bankruptcy proceedings. Another recent development demonstrates that that impression is not entirely correct. Kyowa Co., Ltd., a steel-processing company, also ventured into the Japanese real estate business, apparently with disastrous results, during the real estate boom of the late 1980s. In late November the company asked the Tokyo District Court for protection under Japan's bankruptcy law so it could proceed with a restructuring plan. In the postwar period many such companies ultimately have emerged from such proceedings as healthy companies, although the process can take years.

With debts of Y200 billion ($1.5 billion at Y135=$1.00) Kyowa is the biggest company to have entered bankruptcy proceedings in 1990 and one of the largest in the postwar period. (The biggest was the 1985 collapse of Sanko Steamship Co., Ltd., which had debts of Y500 billion or about $3.7 billion.) Kyowa is not the only sizable company besides Itoman facing real estate-related problems, however. "Real estate bankruptcy" has joined "labor shortage bankruptcy" as a leading explanation of recent business failures. Those facing real estate-related bankruptcies are often those that, like Itoman and Kyowa, diversified into real estate from other lines of business.

Most Japanese companies facing bankruptcy are small. While bankruptcy cases declined sharply during the 1984-89 period, the trend may have been reversed in late 1990 (see Table). October 1990 saw the first year-to-year upturn since December 1984. The October rate is still far below that of the early to mid-1980s, however.

Corporate Bankruptcies in Japan, 1983-90

(firms with debts of Y10 million or more)

		Number of Cases	Change from Year-Earlier Period	Total Debt (billions of yen)
1983		19,155	11.9%	Y2,584
1984		20,841	8.8	3,644
1985		18,812	-9.7	4,236
1986		17,476	-7.1	3,831
1987		12,655	-27.6	2,122
1988		10,122	-20.0	2,001
1989		7,234	-28.5	1,232
1990	January	455	-24.7	68
	February	448	-25.0	77
	March	502	-36.1	87
	April	526	-22.4	167
	May	501	-24.1	225
	June	516	-18.7	104
	July	482	-12.5	87
	August	514	-8.5	118
	September	531	-6.2	91
	October	646	9.7	150

Source: Tokyo Shoko Research

With labor markets still tightening, interest rates showing no sign of easing significantly and unsold real estate properties multiplying, bankruptcies are likely to increase in coming months, in part because some avenues of escape from financial difficulty have closed. Itoman, for example, has seen the value of its portfolio of stocks decline, reducing the cash it otherwise could raise. In addition, many of its largest holdings are bank stocks, which could be adversely affected by the company's shaky financial position. For the typical large company that plunged into real estate, however, one obvious escape route remains: a renewed emphasis on its core business. Since most industries still show strong profits, such companies probably would find a safe haven. While Itoman's plight would seem to suggest the potential for a viral-like spread of financial difficulty, the overall health of the Japanese economy is likely to prevent such a development.

Douglas Ostrom

Tokyo Supports U.N. Resolution To Use Force Against Iraq

Although not currently a member of the United Nations Security Council, Japan joined its Western allies in supporting the November 29 Security Council resolution authorizing the use of force against Iraq if Baghdad fails to withdraw from Kuwait by January 15, 1991. Prime Minister Toshiki Kaifu, fielding questions from reporters November 30, said that the latest U.N. action will strengthen the effectiveness of the 11 resolutions previously passed by the Security Council condemning Saddam Hussein's August 2 invasion of its oil-rich neighbor. Mr. Kaifu was careful to emphasize, however, that Tokyo's support for a peaceful solution to the Persian Gulf crisis remains unchanged. The Japanese government strongly hopes Iraq will recognize that the resolution represents the definitive view of the international community and will pull out of Kuwait, he said.

Given strong domestic sensitivities to the use of military force, chief cabinet secretary Misoji Sakamoto followed Mr. Kaifu's remarks by reiterating Tokyo's continued commitment to a nonviolent resolution to the Persian Gulf crisis. "Japan will maintain an earnest hope right up to the last moment that the crisis will be settled peacefully," Mr. Sakamoto said. He added that the Japanese government appreciates the Security Council's efforts to resolve the matter in accordance with the U.N. charter, which allows the use of force under certain circumstances.

Since Japan is a signatory to the charter, the peacekeeping organization's approval of the use of force against Iraq should make it somewhat easier for relevant government officials to convince Japanese legislators that Tokyo can and should contribute more than simply money to help resolve this regional conflict, Japanese analysts contend. The 12-2 vote especially relieved those who feared that unilateral military action by the United States would have complicated policymakers' efforts to build support for a more active Japanese approach to this crisis.

Ever since Saddam Hussein's armed forces moved into Kuwait over four months ago, the United States and other allies have urged Tokyo to provide a "visible symbol" of its support for the multinational peace effort (see JEI Report No. 35B, September 14, 1990). A proposal that attempted to respond to

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NO. 47A December 14, 1990

JAPAN'S FOREIGN AID POLICY: 1990 UPDATE

Summary

The last 12 months or so have been particularly significant for Japan's foreign aid program. Now recognized as the world's largest donor of official development assistance after hovering at the number-two position since 1986, Japan earned that distinction by disbursing a near-record level of grants and loans to developing countries and multilateral aid organizations in 1989. At the same time international expectations based on Japan's economic strength as well as dramatic global political changes challenged Tokyo to assume even greater responsibility in the aid arena. The Japanese government responded by taking a stronger leadership position on some aid issues and moving toward a slightly more politically assertive foreign aid program.

1989's Aid Scorecard

Japan disbursed $9 billion in official development assistance in 1989 -- well over twice what it had spent just five years earlier. Those outlays qualified Japan as the top foreign aid donor among the 18 nations on the Development Assistance Committee of the Organization for Economic Cooperation and Development (see Table 1). Since 1986 Japan had been very close to being ranked the world's largest donor of foreign aid. An overdue payment to the World Bank's International Development Association helped keep the United States in the top donor position in 1988, but last year American net disbursements fell to under $7.7 billion. That dropped this country to the number-two donor spot, the OECD reported this past June.

Ironically, a less-then-record amount of foreign aid earned Japan the top slot, but the 1.9 percent decline from 1988's all-time-high disbursement of

$9.1 billion simply was a function of the greater strength of the dollar last year. In 1989 the dollar averaged Y137.96; the year before the comparable figure was Y128.15. In both yen and real terms, however, Japan's ODA disbursements set records in 1989. On a yen basis outlays increased 5.7 percent, going from Y1,171 billion to Y1,237 billion. Moreover, after adjustments for changes in prices and the yen-dollar exchange rate Japan's total 1989 foreign aid disbursements were up 4 percent.

A return to more normal patterns of funding for multilateral institutions was largely responsible for the $1.6 billion drop in the flow of ODA funds going to developing countries and multilateral institutions from DAC participants in 1989, the OECD said. Partly as a result, foreign aid as a percentage of gross national product for the 18 DAC members combined slipped from 0.36 percent to 0.33 percent (see Table 2). As in 1988 Japan's foreign aid last year amounted to 0.32 percent of its GNP, ranking it 12th among DAC members. The United States placed last in this category, giving 0.15 percent of its GNP in 1989 compared to 0.21 percent the previous year.

Addressing New Aid Targets

Many of Japan's 1989 ODA efforts were in response to the fourth medium-term foreign aid plan announced in June 1988. This plan replaced the short-lived "Third Medium-Term Target," which included a goal of disbursing $7.6 billion for 1990, double the amount disbursed in 1985. The appreciation of the yen between 1985 and 1988 greatly facilitated the achievement of this target and led Tokyo to outline a new, more ambitious aid plan.

One objective outlined by the five-year program is to raise the quantity of assistance so that Japan's share of the DAC total better corresponds to its proportion of the combined gross national product of the 18 member countries; a connected objective is to bring Japan's ODA/GNP ratio closer to the DAC average. Other aspirations include: improving the quality of Japan's economic assistance and strengthening the aid implementation system through increased staff and coordination with the private sector. The quality improvements are expected to come through the provision of more grants and technical assistance, increased support for international organizations and the introduction of greater lending flexibility and diversification.

The extent to which Japan has been able to make progress on these objectives reflects to a degree how much Tokyo has responded to foreign scrutiny of its economic assistance program. Many analysts believe international pressure has played a major part in bringing about a variety of program changes, including those made in line with the most recent ODA plan.

Aid Levels - The Japanese government set out to accomplish the first of its targets for the 1988-92 period by more than doubling the aggregate volume of foreign aid disbursed between 1983 and 1987. Tokyo expects to offer more than $50 billion in assistance during these five years. Although the Ministry of Foreign Affairs has cautioned that changes in exchange rates may make it harder to deliver on the latest five-year aid plan, the initial FY 1990 budget

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Table 1: ODA of Major Donor Countries, 1985-89

(in millions of dollars; net disbursements)

1989 Rank	Country	1985	1986	1987	1988	1989*	Share of Total DAC ODA 1989*
1	Japan	$3,797	$5,634	$7,342	$9,134	$8,958	19.3%
2	United States	9,403	9,564	8,945	10,141	7,664	16.5
3	France**	3,995	5,105	6,525	6,865	7,467	16.0
4	West Germany	2,942	3,832	4,391	4,731	4,953	10.7
5	Italy	1,099	2,404	2,615	3,193	3,325	7.2
6	United Kingdom	1,530	1,737	1,871	2,645	2,588	5.6
7	Canada	1,631	1,695	1,885	2,347	2,302	5.0
DAC Total		29,429	36,663	41,426	48,132	46,498	100.0

*Preliminary.
**Including overseas territories and prefectures.

Source: Organization for Economic Cooperation and Development

Table 2: ODA as Percentage of GNP for DAC Countries, 1985-89

(in millions of dollars; net disbursements)

1989 Rank		1985 Amount	1985 Percent of GNP	1986 Amount	1986 Percent of GNP	1987 Amount	1987 Percent of GNP	1988 Amount	1988 Percent of GNP	1989* Amount	1989* Percent of GNP	Percent Change 1988-89*
1	Norway	$574	1.01%	$798	1.20%	$890	1.09%	$985	1.10%	$919	1.02%	-6.7%
2	Denmark	440	0.80	695	0.89	859	0.88	922	0.89	1,003	1.00	8.9
3	Sweden	840	0.86	1,090	0.85	1,375	0.88	1,534	0.86	1,809	0.98	18.0
4	Netherlands	1,136	0.91	1,740	1.01	2,094	0.98	2,231	0.98	2,094	0.94	-6.2
5	France**	3,995	0.78	5,105	0.72	6,525	0.74	6,865	0.72	7,467	0.78	8.8
6	Finland	211	0.40	313	0.45	433	0.49	608	0.59	705	0.63	16.0
7	Belgium	440	0.55	547	0.48	687	0.48	618	0.41	716	0.47	15.9
8	Canada	1,631	0.49	1,695	0.48	1,885	0.47	2,347	0.50	2,302	0.44	-1.9
9	West Germany	2,942	0.47	3,832	0.43	4,391	0.39	4,731	0.39	4,953	0.41	4.7
10	Italy	1,098	0.31	2,404	0.40	2,615	0.35	3,193	0.39	3,325	0.39	4.1
11	Australia	749	0.48	752	0.47	627	0.34	1,101	0.46	1,017	0.37	-7.6
12	Japan	3,797	0.29	5,634	0.29	7,342	0.31	9,134	0.32	8,958	0.32	-1.3
13	United Kingdom	1,530	0.33	1,737	0.31	1,871	0.28	2,645	0.32	2,588	0.31	-2.1
14	Switzerland	302	0.31	422	0.30	547	0.31	617	0.32	559	0.30	-9.5
15	Austria	248	0.38	198	0.21	201	0.17	301	0.24	282	0.23	-6.4
16	New Zealand	54	0.25	75	0.30	87	0.26	104	0.27	87	0.22	-16.0
17	Ireland	39	0.24	62	0.28	51	0.19	57	0.20	49	0.17	-12.9
18	United States	9,403	0.24	9,564	0.23	8,945	0.20	10,141	0.21	7,664	0.15	-24.4
DAC Total		29,429	0.35	36,663	0.35	41,426	0.34	48,132	0.36	46,498	0.33	-3.4

*Preliminary.
**Including overseas territories and prefectures.

Source: Organization for Economic Cooperation and Development for economic cooperation represented the largest percentage increase -- 7.8 percent -- of any discretionary spending category in the general account budget (see JEI Report No. 26A, July 6, 1990).

Japan's bilateral aid disbursements increased 13.6 percent in 1989 in yen terms and 5.6 percent in dollar terms (see Table 3). Of the assistance going to specific countries, 55.2 percent consisted of loans. About 44.8 percent of Japan's bilateral aid was disbursed as grants, down slightly from the 1988 figure of 45.3 percent but up from the 1983-87 average of 43.5 percent. Disbursements to multilateral institutions decreased 13.2 percent in yen terms and 19.4 percent in dollar terms. This drop can be explained in part by timing factors that boosted multilateral disbursements in 1988, including a contribution to the World Bank Japan Special Fund. Largely because of these timing factors, bilateral assistance as a share of Japan's total aid disbursements increased from 70.3 percent in 1988 to 75.6 percent in 1989.

Aid Quality - Improvements in ODA lending quality in 1989 included progress in providing generally untied loans, meaning that funding was not linked to purchases from Japanese firms. Tokyo reported that 80.5 percent of all ODA loans were untied last year, up from 77.4 percent in 1988 and an average 53.9 percent for the four-year period between 1984 and 1987. In addition, the government calculated, just 38 percent of loan-funded procurements went to Japanese corporations in 1989, down from 43 percent the year before. The Overseas Economic Cooperation Fund, which is responsible for overseeing the concessionary loan portion of Japan's foreign aid program -- loans below market interest rates and with extended repayment periods, also improved the quality of its loans last year. The grant element (a reflection of the "softness" of lending conditions) of OECF loans committed to foreign governments last year reached 58.9 percent, up from 58.0 percent the previous year.

Another reflection of Japan's efforts to improve the quality of its aid is the 1989 rise in the share of assistance allocated to basic human needs: 28.2 percent compared with 25.9 percent a year earlier. More dramatic is the shrinking amount of aid earmarked for economic infrastructure projects in recent years, which dropped from 49.2 percent in 1987 to 31.7 percent in 1989. Experts point to this as an area of real progress in the aid program, but they note that shifts away from this funding objective can go only so far before clashing with Japanese business interests as well as the need for infrastructure development and rehabilitation in many recipient countries.

Debt Relief - The government's 1989 debt-relief efforts included an expansion announced in July that year of its financial recycling scheme. The program was launched in 1987 to use the benefits of Japan's current account surplus to ease the debt problems of developing countries and to support Third World development efforts (see JEI Report No. 41A, October 30, 1987). The increase outlined in July 1989 boosted the scale of the program to $65 billion and the implementation period to five years, ending in FY 1991 (see JEI Report No. 28B, July 21, 1989). During a September 1989 trip to Mexico Prime Minister Toshiki Kaifu announced that a $1.4 billion loan for debt relief would be expedited for Mexico, then the world's second most heavily indebted developing country.

Japan has continued to demonstrate a resolve not to undermine the conditions on debt relief set by international lending institutions. In September Tokyo agreed with other donors to schedule the next meeting of the consultative group of the Multilateral Assistance Initiative for the Philippines only after

Table 3: Net Flow of Financial Resources from Japan to Developing Countries and Multilateral Agencies, 1985-89

(in millions of dollars; net disbursements)

Type of Transaction	1985	1986	1987	1988	1989	Percent Change 1988-89
Official Development Assistance	$3,797	$5,634	$7,454	$9,134	$8,965	-1.9%
Change Over Previous Year	-12.1%	48.4%	32.3%	22.5%	-1.9%	
ODA/GNP Ratio	0.29%	0.29%	0.31%	0.32%	0.32%	
Bilateral Assistance	2,557	3,846	5,248	6,422	6,779	5.6%
Grants	1,185	1,703	2,221	2,908	3,037	4.5%
Grant Assistance	636	855	1,154	1,483	1,556	4.9%
Technical Assistance	549	849	1,067	1,425	1,481	4.0%
Development Lending and Capital	1,372	2,143	3,027	3,514	3,741	6.5%
Grants, Capital Subscription and Loans to Multilateral Agencies	1,240	1,788	2,207	2,712	2,186	-19.4%
Addendum:						
ODA in Yen Terms (billions)	Y906	Y950	Y1,078	Y1,171	Y1,237	5.7%
Change Over Previous Year	-11.7%	4.8%	13.5%	8.6%	5.7%	

Source: Ministry of Foreign Affairs

Manila met International Monetary Fund criteria for improving its fiscal and monetary policies. Moreover, further disbursement of Japanese aid to the Philippines (with the exception of disaster relief) is contingent on Manila meeting these criteria (see JEI Report No. 29A, July 27, 1990). And, despite giving Peru's then president-elect, Alberto Fujimori, a warm welcome this past July, Tokyo did not waver from its refusal to make additional loan commitments to Peru until that country meets its international creditors' demands and institutes an economic reform plan.

Regional Distribution of Aid - Every region except the Middle East received a larger dollar amount of Japanese bilateral aid in 1989 than 1988, but the distribution altered slightly from the previous year (see Table 4). Last year 62.5 percent of Japan's bilateral assistance went to Asia, a minor drop from 1988's proportion but some improvement on the average 65.9 percent share that went to this region during the 1983-87 period. This shift reflected Tokyo's continuing effort to go beyond the 70-10-10-10 geographic formula adopted in the 1970s. Africa's share of Japanese bilateral ODA reached 15.3 percent last year, in comparison to the 13.8 percent in 1988 and an average 9.8 percent in the mid-1980s, reflecting steady increases in aid disbursements to this region in past years. Latin America also received a larger share of total bilateral assistance, 8.3 percent compared to an average 8.9 percent during 1983-87 and 6.2 percent in 1988. The Middle East's share, however, dropped from 9.1 percent to 5.4 percent last year, compared to an average 9.25 percent in the mid-1980s.

For the third year in a row Indonesia was the top recipient of Japanese ODA, receiving $1.1 billion-plus in 1989 (see Tables 5 and 6). Although aid disbursements to China were postponed as a result of the military crackdown on prodemocracy student demonstrations in the summer of 1989, China still was the second-largest recipient last year with a figure of $832 million. The Philippines, among the top three recipients of Japanese assistance since 1985, was bumped to fourth place when Thailand received $489 million, topping by $85 million the $404 million received by Manila. Reflecting the increased aid going to Africa, Nigeria and Kenya broke into the top 10 ranks last year, receiving disbursements of $166 million and $148 million, respectively.

Not surprisingly, Asian governments continued to receive the largest share of OECF loan commitments last year, but the proportion dropped from 80.7 percent in 1988 to 77.5 percent. Japan's broadening aid perspective was reflected in the greater number of loan commitments made to countries in Latin America and the Middle East. In another sign of change OECF made its first loan to Poland "for the purpose of supporting reform for freedom and democracy in Eastern Europe and in response to the expectations of international society."

Addressing International Expectations and Criticisms

The rationale for extending a loan to Poland reflects some of the political factors behind Tokyo's recent development assistance decisions. Robert Orr, a professor at Stanford University's Kyoto Center for Japanese Studies, argues that several key factors contribute to Japan's foreign aid policymaking process: concern over international status, fear of isolation, desire to conform to world trends and bureaucratic motives.[1] Both domestic and

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[1] Robert M. Orr Jr., The Emergence of Japan's Foreign Aid Power (New York: Columbia University Press, 1990), p. 146.

Table 4: Japan's Bilateral ODA by Region, 1985-89

(in millions of dollars; net disbursements)

Year	Total	Asia	Middle East	Africa	Latin America	Europe	Oceania	Unallocated
1985	$2,557 (100.0%)	$1,732 (67.8%)	$201 (7.9%)	$252 (9.9%)	$225 (8.8%)	$1 (0.0%)	$24 (0.9%)	$122 (4.8%)
1986	$3,846 (100.0%)	$2,494 (64.8%)	$340 (8.8%)	$418 (10.9%)	$317 (8.2%)	$2 (0.1%)	$55 (1.4%)	$221 (5.7%)
1987	$5,248 (100.0%)	$3,416 (65.1%)	$526 (10.0%)	$516 (9.8%)	$418 (8.0%)	$2 (0.0%)	$68 (1.3%)	$302 (5.8%)
1988	$6,422 (100.0%)	$4,034 (62.8%)	$583 (9.1%)	$884 (13.8%)	$399 (6.2%)	$4 (0.1%)	$93 (1.4%)	$425 (6.6%)
1989	$6,779 (100.0%)	$4,240 (62.5%)	$368 (5.4%)	$1,040 (15.3%)	$563 (8.3%)	$11 (0.2%)	$98 (1.4%)	$458 (6.8%)

Source: Ministry of Foreign Affairs

Table 5: Major Recipients of Japan's ODA, 1985-89

(in millions of dollars; net disbursements)

1985		1986		1987		1988		1989	
Country	Amount	Country	Amount	Country	Amount	Country	Amount	Country	Amount
China	$388	China	$497	Indonesia	$707	Indonesia	$985	Indonesia	$1,145
Thailand	264	Philippines	438	China	553	China	674	China	832
Philippines	240	Thailand	260	Philippines	379	Philippines	535	Thailand	489
Indonesia	161	Bangladesh	248	Bangladesh	334	Thailand	361	Philippines	404
Burma	154	Burma	244	India	304	Bangladesh	342	Bangladesh	371
Malaysia	126	India	227	Thailand	302	Pakistan	302	India	257
Bangladesh	121	Indonesia	161	Malaysia	276	Myanmar/Burma	260	Sri Lanka	185
Pakistan	93	Pakistan	152	Burma	172	Sri Lanka	200	Pakistan	177
Sri Lanka	84	Sri Lanka	127	Turkey	162	India	180	Nigeria	166
Egypt	73	Egypt	126	Pakistan	127	Egypt	173	Kenya	148

Source: Ministry of Foreign Affairs

Table 6: Major Recipients of ODA, 1987/88

(percent of total ODA by donor country; gross disbursements)

Japan		United States		All DAC Countries	
Indonesia	11.9%	Israel	12.0%	Indonesia	3.7%
China	6.6	Egypt	9.4	Egypt	3.4
Philippines	5.7	El Salvador	3.3	India	2.9
Thailand	4.3	Pakistan	2.7	Israel	2.8
Bangladesh	3.9	Philippines	1.8	China	2.2
India	3.6	India	1.7	Bangladesh	2.0
Pakistan	2.7	Pacific Islands	1.6	Pakistan	1.9
Malaysia	2.6	Honduras	1.5	Philippines	1.8
Burma	2.5	Guatemala	1.4	Tanzania	1.6
Korea	2.4	Costa Rica	1.3	Mozambique	1.4
Sri Lanka	1.8	Bangladesh	1.3	Kenya	1.2
Turkey	1.8	Sudan	1.0	Reunion	1.2
Egypt	1.6	Jordan	0.9	Thailand	1.2
Kenya	1.2	Indonesia	0.9	Turkey	1.1
Brazil	0.9	Morocco	0.9	Sudan	1.0
Syria	0.9	Jamaica	0.8	Ethiopia	0.9
Zambia	0.8	Bolivia	0.8	Martinique	0.9
Tanzania	0.8	Peru	0.7	Sri Lanka	0.9
Nepal	0.8	Haiti	0.7	Morocco	0.9
Sudan	0.7	Dominican Republic	0.6	El Salvador	0.8
Paraguay	0.6	Mexico	0.6	Zaire	0.8
Bolivia	0.5	Mozambique	0.6	Zambia	0.8
Malawi	0.5	Zaire	0.5	Senegal	0.8
Ghana	0.5	Kenya	0.5	Somalia	0.8
Honduras	0.4	Tunisia	0.5	Polynesia, French	0.7
Subtotal	60.1	Subtotal	48.1	Subtotal	37.5
Multilateral	26.4	Multilateral	25.9	Multilateral	27.5
Unallocated	3.8	Unallocated	16.8	Unallocated	11.4
Total ODA*	$9,303	Total ODA*	$10,186	Total ODA*	$47,656

*In millions of dollars.

Source: Organization for Economic Cooperation and Development, Development Co-operation in the 1990s: 1989 Report.

international interests have compelled Japan to seek a degree of global responsibility more in line with its economic strength. Such burdensharing can be demonstrated not only through the quantity and the quality of its aid but by the direction of Tokyo's aid policies. The United States and other allies recently have urged Japan to use its financial resources to support common security and political objectives as well as economic goals.

Some observers suggest that concerns about its international image also compelled Tokyo in 1988 to join other donor countries in suspending disbursements to longtime aid recipient Myanmar, formerly called Burma, to protest

Rangoon's alleged human rights violations. In March 1989 Tokyo resumed some assistance to that country, a decision that Mr. Orr ascribed to bureaucratic and private-sector concerns about the potential financial impact that could result from terminating support for a country that long had been dependent on Tokyo for economic assistance.[2] The Myanmar case also exemplifies how decisions on Japan's aid program are complicated by the interplay between the four agencies that share various administrative functions in Japan's foreign aid program -- the Ministries of Foreign Affairs, Finance and International Trade and Industry plus the Economic Planning Agency. (For background on Japan's policymaking apparatus for economic assistance, see JEI Report No. 41A, October 27, 1989.)

International expectations also play a part in Tokyo's stepped-up aid program for Africa. In July 1989 Tokyo announced that it would provide $600 million in nonproject grants to sub-Saharan Africa over a three-year period; the program augmented a 1987 commitment of $500 million in grants for the region. The Japanese government cites this effort as an example of the flexible approach it acknowledges as more appropriate for conditions in developing countries than the project-type assistance favored in the past. Providing low-income African countries with nonproject grants also may help the Japanese government counter the three-pronged international criticism that its aid program concentrates too heavily on Asia, channels too much money into infrastructure projects that serve Japan's economic interests and relies too much on loans.

Changes in the type of countries to which Tokyo directs economic assistance may drive changes in the nature of Japanese aid as much as policy decisions, according to Larry Nowels of the Congressional Research Service. A greater emphasis on poorer countries in Africa and Asia, he notes, most likely will increase the proportion of grants and loans extended on concessional terms, a development that also will respond to criticism of the quality of Japan's aid program.[3] Although Japan traditionally has favored loans in line with an aid philosophy that emphasizes economic self-sufficiency, donor nations and aid experts alike generally consider grants to be higher-quality aid. The 75.4 percent grant element of Japan's total ODA commitments was lower than any other member of the DAC in 1987, the last year for which comparative data are available.

Another persistent criticism of Japan's economic assistance program is that it is linked too closely to the country's commercial interests, a complaint based on Japan's tendency in the past to tie its aid to purchases of goods and services from Japanese businesses. Tokyo's attempt to untie its foreign aid has won recognition from many American analysts and officials. OECD figures show that in 1988 Japan's aid was 80 percent untied and 20 percent fully or partially tied, while American aid was 10 percent untied and 90 percent completely or partially tied.

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[2] Orr, op. cit., p. 85.

[3] Larry Q. Nowels, "Japan's Foreign Aid Program: Adjusting to the Role of the World's Leading Donor" in Japan's Economic Challenge: Study Papers Submitted to the Joint Economic Committee, Congress of the United States (Washington, D.C.: Government Printing Office, 1990), p. 404.

Some observers contend that these figures misrepresent the bottom line of the tied aid issue: which country ultimately gets the contracts. Critics claim that Japan's "request-based" aid system continues to give Japanese firms an advantage in supplying untied or partially untied (open to contractors from developing countries as well as the donor country) projects. In contrast, a General Accounting Office study completed in May 1990 concluded that Agency for International Development statistics may overstate the degree to which American bilateral assistance is tied to domestic procurement because AID policies allow greater opportunities for other suppliers than formally stated.[4]

Yet many in Washington remain concerned that American contractors are losing out on opportunities to supply foreign aid projects funded by Japan. In another of the White House's periodic attempts to force other countries to stop tying their aid, the Bush administration announced plans in mid-May to merge funds from the Export-Import Bank and AID to create a $500 million pool of money for projects tied to American contracts (see JEI Report No. 21B, May 25, 1990). In a related move Congress approved in October an amendment to the FY 1991 foreign aid appropriations bill increasing the cap on tied-aid credits from $50 million to $300 million.

Mr. Orr of Stanford University's Kyoto Center notes, however, that international pressure on Japan to increase the grant element of its aid may undermine simultaneous pressure to reduce the tied nature of its economic assistance. He points out that it will be difficult for the Japanese government to rationalize totally untied grants and loans since the money for this assistance comes from the taxpayer-funded general account budget.[5] Other observers concur that the political strength of Japanese businesses will ensure a continuing relationship between private-sector interests and Tokyo's aid program.

Other Challenges Facing Japan's Foreign Aid Program

Criticism at home of Japan's economic assistance policy hints at other problems the program may have difficulty overcoming. Reports from Tokyo this spring cited complaints that recipients of Japanese ODA were not using the funds effectively and that Prime Minister Kaifu was exploiting aid-related visits to developing nations for domestic political purposes. The reports also noted growing concern within Japan that Tokyo's aid efforts were hampered by poor distribution systems in recipient countries and were at times harmful to the environment of Third World countries. In a June assessment of 145 aid projects the Foreign Ministry also acknowledged that Japan's aid program has suffered from shortcomings in follow-up. A major problem for the program is that the aid bureaucracy is too understaffed to handle the workload created by the rapid growth of the aid budget. In 1988, for example, the government had only 357 ODA officials overseas.

[4] U.S. General Accounting Office, Economic Assistance: Integration of Japanese Aid and Trade Policies (Report to the Chairman, Subcommittee on Economic Resources and Competitiveness, Joint Economic Committee, U.S. Congress) (Washington, D.C.: 1990), p. 10.

[5] Orr, *op. cit.*, p. 140.

The FY 1990 foreign aid budget attempts to address this problem by including funding, albeit in limited amounts, for additional personnel. Project evaluation units also will be set up in the Finance Ministry and the Japan International Cooperation Agency, which coordinates the public sector's technical assistance program. Moreover, $34 million has been earmarked for the establishment of an International Development University. Whether these efforts are sufficient to make a difference in the staffing problem is unclear. Analysts agree, however, that without a stronger base of aid experts Japan's program is likely to face intensified project oversight and implementation problems. The shortage of trained aid experts also increases the government's reliance on the private sector to carry out the technical assistance portion of its program (see JEI Report No. 43A, November 9, 1990).

Greater coordination with the American aid program has been proposed as one means of tackling Japan's personnel shortages. In 1989 AID and Foreign Ministry officials met to discuss possible cooperative efforts. For a variety of logistical and other reasons, however, progress on this idea appears to be making little headway. Lori Forman, an aid expert who was closely involved in some of these discussions, says she is not optimistic that collaborative efforts will be pursued aggressively.[6]

Tokyo also has struggled to counter criticism that it does not adequately consider the environmental impact of the projects it funds. In a summary of the 1990 ODA report the Foreign Ministry noted: "Further efforts should be made to enhance the ability of developing countries to deal with environmental issues." Some aid experts are skeptical, however, of the understaffed Japanese aid bureaucracy's present ability to design and oversee projects that are environmentally sound. Recent initiatives cited as steps in the right direction include funds for projects to refine lead-free gasoline and to rehabilitate railway locomotives in Mexico, which form part of a Y122.8 billion ($909.6 million at Y135=$1.00) loan package to that country announced in June. These monies are the first disbursement of a Y300 billion ($2.2 billion) fund to be distributed over the FY 1989-FY 1991 period to protect the environment. Similarly, Tokyo's decision this summer to stop its participation in funding the Sardar Sarovar dam project in India was welcomed by several environmental groups, which charged that the project would displace 100,000 people.

Private Sector and Nongovernmental Organizations

Japanese official development assistance for Third World countries is augmented by other official flows, private flows and grants by private voluntary agencies. The 1989 total of $24.1 billion represented a 12.6 percent increase from the previous year (see JEI Report No. 40B, October 19, 1990). In addition to the nearly $9 billion in ODA money, $1.5 billion in other official flows (such as export credits and direct investment) went to developing countries. Private flows topped $10 billion for the first time, a 5.3 percent increase from 1988. Grants by private voluntary agencies increased 13.7 percent from 1988's level to $122 million, the report said.

Nongovernmental organizations, only recently very visible in Japan, reportedly have trouble securing public financial support and are hindered by staff shortages. The summary of the 1990 ODA report pointed to the importance of public and government support for NGOs and pledged further efforts to cooperate with NGOs in recipient countries. Last year was the first time funds were allocated for direct disbursements to local NGOs, a development the Foreign Ministry believes will help ensure that Japanese aid reaches the grass roots. In April 1989 Keidanren (Japan Federation of Economic Organizations) created the Japan International Development Organization Ltd. to encourage private-sector involvement in Third World development. Some observers note that frustration with the slow-moving aid bureaucracy led to the JAIDO initiative. This year Keidanren joined the government to establish the Foundation for Advanced Studies on International Development, a training and research organization intended to support personnel interested in international development affairs.

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[6] Interview with Lori Forman, December 4, 1990.

Emerging Trends in Japan's Foreign Aid Program

Critics have contended that Japan's request-based foreign aid approach not only favors Japanese procurement but gives Tokyo an excuse to avoid greater international leadership through its assistance efforts. Although Tokyo traditionally has argued for an "apolitical" position as an aid donor, officials appear to be increasingly willing to ease away from this approach. The 1990 ODA report cited efforts to improve the policy dialogue with aid recipients as well as the provision of "policy-based loans" as two improvements in Japan's aid program. Even more telling was the report's discussion of directions that the program should take in the future.

A report summary noted that while continuing to build on an aid philosophy based on "humanitarian considerations" and "recognition of interdependence," Japan may want to link its foreign aid policy more directly to the values of freedom and democracy (see JEI Report No. 40B, October 19, 1990). According to the Foreign Ministry, "Japan will seek more involvement in [recipient countries'] economic and social policies by way of political dialogue" and will take full account in bilateral approaches "of the need to support those countries that are working toward greater democracy." Japanese press accounts of the report noted that it questioned whether Tokyo should continue its policy of not attaching political conditions to bilateral aid.

The report also acknowledged the political nature of several "exceptional" aid initiatives recently taken by Tokyo, including its promise to extend economic assistance to newly democratizing Eastern European countries and the temporary suspension of aid to China, blacklisted by industrialized nations for its June 1989 crackdown on dissent. The document suggested that similar initiatives to support world peace could find a place in official policy in the future. It also noted that the Japanese aid program could respond to changing international conditions through such means as requiring aid recipients to follow development models favored by Japan.

Important Japanese Aid Initiatives in 1990

Several recent aid initiatives hint at Tokyo's apparent willingness to allow the aid program to play a greater political role. While some of these decisions clearly were a response to international pressure, others reflected attempts to take the lead on certain aid issues. For example, this past summer Mr. Kaifu announced Japan's intention to resume aid discussions with China. He was able to secure qualified approval of this action from the United States and other Western allies at the summit meeting in Houston (see JEI Report No. 29B, July 27, 1990). In explaining its decision to move ahead on the six-year, Y810 billion ($6 billion) aid package originally scheduled to go into effect in April 1990, Tokyo cited Japan's unique economic relationship with China and its conviction that China not be isolated. Moreover, Mr. Kaifu emphasized Japan's intention to continue to pressure Beijing to improve its human rights policies.

After numerous bilateral discussions the Japanese government in early November announced its decision to extend a loan on concessional terms of up to Y36.5 billion to China ($270.4 million) for seven infrastructure projects "in order to contribute to [China's] economic stability and to promote economic modernization efforts." The Foreign Ministry said that the release of money to fund the rest of the package will be done on a step-by-step basis contingent on Beijing's movement toward reform and openness.

Pointing to President Bush's quiet support for Japan's decision, some analysts believe the United States might encourage Tokyo to take the lead in other situations where U.S. policy does not permit certain actions.[7] One such case may be Vietnam. The Foreign Ministry told Hanoi earlier this year that it cannot extend aid until the Cambodian conflict is resolved. Japan is said to be eager, however, to resume full-fledged economic assistance to Vietnam and has hinted at its willingness to extend aid to speed the resolution of conflicts in the region. Once such actions become politically feasible Japan is expected to direct large amounts of much-needed aid to the countries of Indochina. Tokyo appears more inclined to take the political lead in Asia, rather than elsewhere, since Japan has a powerful presence based on foreign aid and investment there. Although the government still must tread carefully, Japan's Asian neighbors seem increasingly willing to let it assume a greater political role in the region.

In other cases critics have complained that Tokyo has been slow to act either politically or financially as a world leader. This fall many American legislators criticized the delay as well as the nature and the amount of Japan's initial assistance to its allies in response to the Iraqi invasion of Kuwait. Tokyo's late August commitment of $1 billion in logistical aid to the multilateral forces in the Middle East was followed in mid-September by the promise of an additional $1 billion in logistical support plus $2 billion in economic aid for those nations most harmed by the trade embargo against Iraq (see JEI Report No. 36B, September 21, 1990).

The Foreign Ministry countered the criticism by pointing out that Japan's commitment to the Middle East peacekeeping effort was a policy "breakthrough" that "would not have been conceivable some years ago."[8] Mr. Orr of Stanford University's Kyoto Center notes that in the past Japan took important steps in its Middle East aid policy, moving toward resource diplomacy and a broader global perspective, but he concludes that initiatives in the region have come primarily in reaction to events and foreign pressure.[9]

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[7] Edward J. Lincoln cited in "Why aid to China is a high-stakes gamble for Japan," Business Week, July 30, 1990, p. 39.

[8] Taizo Watanabe cited in T.R. Reid, "Snags Prevent Japanese From Delivering Promised Aid to Persian Gulf Forces," Washington Post, September 4, 1990, p. A21.

While Prime Minister Kaifu was urging the leaders of other industrial nations at the Houston summit to ease the line on aid to China, he also was fighting West German and French proposals to extend economic assistance to the Soviet Union. Recently, however, the government appears to have softened slightly its long resistance to providing aid to the Soviet Union. Tokyo has linked economic assistance and normalization of relations with Moscow to the resolution of a 45-year-old dispute over the status of four Soviet-occupied, Japanese-claimed islands north of Hokkaido. The Foreign Ministry's budget proposal for fiscal 1991, however, included a first-time request for funds to assist the Soviet Union, partly to be directed toward supporting the government's *perestroika* (restructuring) program. Moreover, in late November the cabinet approved plans to direct Y2.6 billion-plus ($19.3 million) in emergency aid to the Soviet Union as part of the FY 1990 supplementary budget. The funds are intended to provide medical aid to victims of the 1986 accident at the Chernobyl nuclear power plant. Although Tokyo continues to rule out full-fledged economic assistance to the Soviet Union, the Foreign Ministry reportedly contends that the Northern Territories dispute does not prevent Japan from extending emergency humanitarian aid.

Outlook for Japan's Foreign Aid Program

The emergence of Japan as the world's top aid donor presents challenges to Tokyo as well as to Washington. Coordination in foreign aid policy has been a bright spot in U.S.-Japan relations even when other areas of the relationship have been rocky. As reflected in several events this year, the importance of the aid relationship seems likely to grow. After acting as the world's greatest wellspring of economic assistance for more than four decades, the United States now faces financial constraints that compel policymakers to look to others, particularly Japan, to take on a bigger share of the growing international burden.

The Middle East crisis as well as the shadows cast by the enormous federal budget deficit and the U.S.-Japan trade imbalance have intensified the burdensharing debate this year. Some observers speculate that the strain on the American aid program may persuade Japan to fill some of the gaps. Aid experts predict that Tokyo will continue to widen its global perspective, but Japanese officials warn that domestic support for the aid program may weaken if economic assistance is tied too closely to U.S. strategic interests.[10] Moreover, American policymakers increasingly are recognizing that burdensharing is linked with sharing power and responsibility; the implications of this for the United States remain to be addressed.

The 7.8 percent initial increase in the foreign aid budget for FY 1990 was the largest percentage rise of any discretionary budget category for the

[9] Robert M. Orr Jr., "Balancing Act: Japanese Foreign Aid Policy in the Middle East" in Edward J. Lincoln (ed.), *Japan in the Middle East* (Washington, D.C.: The Middle East Institute, forthcoming).

[10] Nowels, *op. cit.*, p. 402, and interview November 30, 1990.

current fiscal year; the budget requested for FY 1991 points to additional growth in the foreign aid area. Yet aid experts disagree on how long Tokyo will continue to boost its aid expenditures. Some believe funding soon will level off now that Japan leads the pack of donor nations. Others warn that expanding loans to Third World countries correspondingly increase the debt problems of recipient nations. This concern suggests that future challenges facing Japan's aid program will stress the quality of economic assistance as well as ways to help ease the international debt crisis. Meanwhile, both recipient nations and other donors will be watching to see whether Japan will be able to deliver on the political leadership hinted at by some of its recent aid policy decisions.

For further information, contact Margo Grimm.

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Japan's GNP Continues To Expand

Almost a year ago the Economic Planning Agency said it expected Japan's economy to expand at an inflation-adjusted 4 percent clip over the fiscal year beginning April 1, 1990. In early December EPA reported that the real gross national product grew during the July-September quarter at an annualized 4.1 percent rate (see Table), slightly faster than foreseen in its earlier outlook. Even in the highly unlikely event that the economy were to contract over the two remaining quarters of FY 1990, the projected 4 percent figure would be achieved. Yet nearly all Japanese analysts reacted glumly to the latest GNP figures. (All the figures in the table reflect EPA's recent switch from 1980 to 1985 as the base year for calculating real GNP. As such, they are not strictly comparable with figures reported earlier.)

Part of the reason for the sour looks on analysts' faces was that they had expected far better a few months ago. During the summer, for example, the Japan Economic Research Center had forecast that price-adjusted growth during the July-September quarter would exceed 10 percent annualized. Even JERC's scaled-back November estimate of 6.6 percent was far above the rate actually recorded.

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1988	FY 1989	October-December 1989	January-March 1990	April-June 1990	July-September 1990
Gross National Product	Y370,354.3 (5.9%)	Y388,245.8 (4.8%)	Y391,200.9 (5.4%)	Y397,491.7 (6.6%)	Y402,877.4 (5.5%)	Y406,944.6 (4.1%)
Personal Consumption Spending	216,681.4 (5.5%)	225,538.8 (4.1%)	228,793.4 (8.2%)	229,536.8 (1.3%)	233,094.6 (6.3%)	233,921.7 (1.4%)
Private Residential Construction	21,565.5 (4.8%)	21,712.5 (0.7%)	21,785.9 (3.5%)	22,080.3 (5.5%)	23,238.8 (22.7%)	24,628.8 (26.2%)
Private Fixed Nonresidential Investment	69,194.8 (16.6%)	78,954.0 (14.1%)	80,529.8 (15.9%)	83,429.0 (15.2%)	85,923.6 (12.5%)	87,439.7 (7.2%)
Change in Business Inventories	3,199.4 (*)	3,616.1 (*)	3,961.4 (*)	2,180.7 (*)	3,348.8 (*)	2,924.3 (*)
Government Current Expenditures	33,023.6 (2.2%)	33,651.5 (1.9%)	33,646.9 (2.3%)	33,901.9 (3.1%)	33,902.0 (0.0%)	33,928.1 (0.3%)
Government Fixed Investment	25,031.0 (0.5%)	25,270.4 (1.0%)	25,294.9 (5.3%)	25,697.3 (6.5%)	25,958.5 (4.1%)	25,983.2 (0.4%)
Change in Government Inventories	-227.9 (*)	-55.5 (*)	-721.0 (*)	203.4 (*)	433.5 (*)	603.0 (*)
Net External Sector	1,886.4 (-67.8%)	-441.8 (-123.4%)	-2,090.4 (*)	462.3 (*)	-3,022.4 (*)	-2,484.2 (*)
Exports of Goods and Services and Factor Income Received	59,309.1 (12.2%)	68,576.2 (15.6%)	68,979.3 (13.0%)	73,638.6 (29.9%)	74,052.7 (2.3%)	70,549.2 (-17.6%)
Imports of Goods and Services and Factor Income Paid	57,422.7 (22.2%)	69,018.0 (20.2%)	71,069.7 (30.2%)	73,176.3 (12.4%)	77,075.1 (23.1%)	73,033.4 (-19.4%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

More worrisome than old forecasts gone awry was what the numbers said about the future. According to the conventional Japanese view, the economy has been sustained by the twin pillars of consumer spending and investment in plant and equipment; these offset the drag exerted by falling real net exports. During the latest quarter net exports changed little, suggesting that the period ought to have been a strong one. The economy ended up weaker than expected, however, because the twin pillars looked a little shaky. Consumer spending inched ahead at a 1.4 percent annualized rate. Capital spending, up 7.2 percent on an annual basis, grew much more slowly than in other recent quarters but still accounted for 0.4 percentage point of the 1 point quarter-to-quarter gain.

Consumer spending as well as plant and equipment investment could look worse in coming months. The most recent available data on department store sales, an admittedly imperfect measure of consumer sentiment, showed a much slower rise on a year-to-year basis in October than in the previous three months, exceeding the rate of inflation by a narrow margin; that suggests overall consumer sentiment still may be weakening. Plant and equipment spending, which depends in part on interest rates and expected future sales, may not fare much better; rates generally rose during the July-September quarter but barely affected the level of investment, given the long lead times involved. However, one leading indicator of future trends, machinery orders, increased 4.7 percent in October over a year earlier, well below the double-digit gains registered in most of 1990; this suggests to analysts that future capital spending, particularly by small businesses, may be comparatively weak in FY 1991.

Private residential construction, up an annualized 26.2 percent, shared top billing with plant and equipment investment as a source of economic expansion in the latest period, adding 0.3 point to the quarterly growth rate. Continuing high interest rates are likely to slow housing starts in coming months, however. Government spending on a GNP basis, flat in the third quarter, is unlikely to rise significantly in the near future. In short, all the major components of domestic demand look comparatively weak over the next few months; should the external sector remain a drag on the economy, overall growth could be anemic.

For these reasons many Japanese analysts now question whether the current expansion, which began in late 1986, will establish a new postwar record for duration. (The old mark of 57 months was set in July 1970.) To do so would require, in EPA's judgment, that a sufficiently large number of economic indicators look positive as of September 1991. Since, by EPA standards, the indicators -- and not the change in the GNP figures -- determine whether or not an expansion is at an end, even a still rising GNP may not be enough to guarantee a positive EPA judgment. Most private forecasters now anticipate real economic growth of between 3 and 4 percent in FY 1991, healthy growth by American standards but probably barely enough for the economy to limp its way to a new record.

Douglas Ostrom

LDP's Proposed Land Tax Panned

The ruling Liberal Democratic Party introduced its version of a new national land-holding tax December 6 and immediately drew criticism from all

NOTE

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JAPAN'S OPPOSITION PARTIES: OPPORTUNITIES LOST

Summary

Many political analysts contend the Japan Socialist Party had a chance to end its status as a "permanent opposition" over the past year but fumbled it. After unprecedented gains in the July 1989 upper house elections gave Japan's political opposition control of this chamber, the opposition parties, of which the largest is the JSP, could have exercised greater influence in the policymaking process. Even the glimmer of someday gaining the leadership of the country seemed possible in the heady days after the upper house vote. The February 1990 contests for the Diet's more powerful lower house, however, brought the political opposition back to earth.

Having failed to capitalize on the apparent widespread disaffection with the ruling Liberal Democratic Party and seize the reins of government, the opposition parties are at a crossroad. They can remain essentially minor political actors. Or they can take steps to build coherent alternatives to LDP-sponsored proposals, address divisiveness among themselves and adapt their platforms to contemporary social, economic and global developments.

The Lower House Elections: Where the Opposition Parties Fell Down

Nearly 18 months ago Japan's opposition parties were humming with the possibilities posed by the ruling Liberal Democratic Party having lost control of one of the Diet chambers for the first time in 35 years. Japanese voters who went to the polls in late July 1989 had selected as representatives to the

Diet's upper house 46 candidates from the Japan Socialist Party, the largest opposition group, versus only 36 LDP candidates to help fill the 126 seats up for election. This boosted the JSP's previous roster of 43 to an all-time high of 72 upper house members. The JSP total combined with the other non-LDP parties gave the political opposition a clear majority in the House of Councillors. (Postelectoral realignments, primarily by independents, have boosted both the LDP and the JSP tallies, but as indicated in Table 1 the opposition parties still hold a majority.)

Table 1: Current Upper House Party Alignment

Party	Seats
Liberal Democratic Party	114
Japan Socialist Party	73
Komeito	20
Japan Communist Party	14
Democratic Socialist Party	10
United Social Democratic Party	0
Progressive Party	0
Rengo	12
Minor Parties	4
Independents	5
Total	252

Some members of Japan's opposition parties -- once described as a "permanent opposition" since they appeared unable to loosen the LDP's grip on power -- viewed the JSP's surge as the foot in the door they needed to eventually seize the reins of government from the ruling party. Although the LDP still held a significant majority in the lower house -- the lead policymaking chamber, which elects the prime minister, the political opposition's control of the upper house potentially had important policy implications. Since the House of Councillors has the final say on nontax, nontreaty legislation passed by the lower house, the opposition parties -- which in addition to the JSP include Komeito, the Democratic Socialist Party, the Japan Communist Party, Rengo and a few small single-issue parties -- had hoped to use their numerical advantage in the upper chamber to block action on critical legislation in an effort to win concessions from the ruling party.

These obstructionist tactics were expected to play well at the grass roots, where disenchantment with LDP politics and policies was running high, at least prior to the February 1990 lower house contests. As the following examines, however, this approach did not convince the Japanese electorate that a JSP-led opposition was ready to rule the country. The factors that previously had limited the opposition parties' political influence continued to hamper their ability to mount an effective challenge to the LDP in the mid-February lower house elections; voters gave the ruling party a significant margin of

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victory. The political opposition, in short, bungled an important opportunity to shift the locus of power.

Poor Electoral Strategy - The JSP picked up 58 new seats in this year's elections for the 512-seat House of Representatives, increasing its tally there to 141 from 83. While a significant increase, the Socialists did not perform as well as they had hoped; in at least 36 "close" races, for example, the ruling party candidate edged out the JSP competitor. Moreover, these gains were at the expense of other opposition parties. Komeito dropped to 46 seats from 55, the JCP to 16 from 27, and the DSP to 14 from 26. The LDP, in comparison, captured approximately 47 percent of the popular vote, which translated into 275 seats, a figure well in excess of the 271 seats the party needed to extend its 35 years of uninterrupted leadership into the near future. (As Table 2 indicates, postelection shifts have increased the LDP bloc.)

Table 2: Current Lower House Party Alignment

Party	Seats
Liberal Democratic Party	284
Japan Socialist Party	139
Komeito	46
Japan Communist Party	16
Democratic Socialist Party	14
United Social Democratic Party	5
Progressive Party	0
Rengo	0
Minor Parties	0
Independents	7
Total	511*

*One seat is vacant.

There is a view that the JSP's gains in the lower house elections were largely "checking votes" against the LDP (see JEI Report No. 12A, March 23, 1990). Analysts have proposed that voters remained concerned about the nature and the direction of ruling party politics and policies in the wake of the previous year's Recruit Co., Ltd. influence-peddling scandal as well as implementation of the 3 percent consumption tax and liberalization of the beef and orange markets. But when it came to determining who should govern the country, the electorate either played it safe by voting LDP or concentrated their anti-LDP votes on the candidates from the largest of the opposition parties as a means of maintaining a close watch on the ruling party and restraining it when necessary, this argument goes.

Several Japanese political analysts nevertheless contend that the opposition parties could have wrested lower house control from the LDP if they had had a better electoral strategy. That the JSP failed to seize the reins of power in February is its own fault, these pundits charge. The Socialists, for example, did not field enough candidates to seriously undermine the LDP's chances of securing at least a simple majority.

Opposing the ruling party's slate of 320 candidates were approximately 155 JSP candidates; 131 from the JCP; 58 from Komeito; 44 for the DSP; and six each from two smaller parties, the United Social Democratic Party and the Progressive Party. In one commentator's words: "Here [the Socialists] had this great chance to prove themselves and they only managed to put up more than one candidate in 29 districts. If they really [had wanted] to take over from the LDP, they [should have] fielded something like 180 to 200 candidates."[1]

The JSP's "egoism" also was a factor, another analyst maintains. As a perennial opposition party without much money, he says, the JSP tried to keep its own coffers as full as possible rather than sharing the funds available to it with its potential coalition partners, the DSP and Komeito.[2] In addition, some political observers feel the Socialists relied too much on a force that had worked well particularly among women voters in the 1989 elections, the charisma of their chairman, Takako Doi. In this view the party failed to cultivate new talent and perhaps overused the magnetism ploy, underestimating voters' desire to move away from some of the 1989 election issues.

Ms. Doi had captured the public's attention by articulating its anger over the April 1989 implementation of the 3 percent consumption tax, liberalization of beef and orange imports and the LDP's Recruit-related unethical behavior. Moreover, she was in the right place at the right time to exploit Japanese women's growing opposition to LDP policies and practices and their general dissatisfaction with the male-dominated worlds of politics and business. Any embarrassment that voters may have felt over then Prime Minister Sosuke Uno's reported extramarital relationship with a geisha also may have enhanced women's disaffection toward the LDP. The Doi-inspired "madonna" strategy, which entailed fielding as many female candidates as possible to woo Japan's growing legions of disenchanted voters, proved successful in the July 1989 upper house contests. Of the 17 women elected to the House of Councillors, 10 were JSP members.

Analysts surmised after the upper house elections that Japanese women propelled the "madonna" candidates into national office because of what they represented symbolically rather than substantively. Japanese voters, aware of the importance of the lower house for the leadership of the country, apparently were less willing to make "symbolic" statements when selecting representatives for this chamber; JSP "madonnas" running for the House of Representatives did not fare as well as in the earlier race. (This outcome may have been linked to Mr. Uno's no longer being prime minister.) The Socialists as well as the other opposition parties, it can be argued, did not showcase effectively any potential leadership talent, female or male.

The opposition parties also allowed themselves to be outmaneuvered by the ruling party on the timing of the lower house elections. After the LDP's crushing defeat in the upper house contests, its leaders believed they stood a better chance of reversing the party's fortunes if they could delay the House of Representatives elections for as long as possible. In the fall of 1989 JSP officials let it be known that they planned to force the dissolution of the lower house in early November by pushing for a vote on an opposition-backed bill to repeal the consumption tax; this action -- similar to a no-confidence vote -- would have helped move up the election schedule.

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[1] Minoru Matsuzaki, "Election '90: The Socialists Miss Their Chance," Japan Echo, XVII, No. 2, Summer 1990, p. 9.

[2] Kotaro Tawara, Kimihiro Masamura and Takashi Inoguchi, "The Sorry State of Japanese Politics," Japan Echo, XVII, No. 2, Summer 1990, p. 14.

LDP strategists countered by raising allegations that some Socialist members had received questionable contributions from operators of pachinko (pinball) parlors (see JEI Report No. 41B, October 27, 1990). Some Japanese political observers believe this stratagem, which helped the ruling party delay the dissolution of the lower house until late January 1990, put the Socialists on the defensive.[3] It took away the high moral ground the JSP had held in the Upper House elections as well as their momentum. That turn of events ultimately deprived the opposition parties of their best chance ever of seizing control of the lower chamber.

No Coherent Policy Proposals - Following its upper house victory, the JSP needed to instill confidence among the electorate that it possessed the "vision" to lead the country by coming forward with coherent alternatives to LDP-led government policies. Instead, the Socialists simply chose to nay-say virtually any ruling party initiative. They continued to rely on reactive policies rather than promoting new ideas able to serve as national policies.

Ms. Doi's tactic of repeatedly "saying no" to the unpopular consumption tax, in particular, had been very effective in the upper house campaigns. But as one commentator remarked, "She apparently [didn't] understand that this tactic [wouldn't] work with tougher and graver issues that could have decisive bearings on the nation's destiny."[4] By early 1990 public opinion polls, in fact, showed that the public's strong feelings about the levy had subsided due, in part, to their realization that it did not hit their pocketbooks as hard as they had feared. It was shortsighted for a party that was seriously interested in moving into power to campaign on a narrow antitax platform, other analysts noted.[5]

Undeterred, the Socialists refused to budge from their position that the tax be abolished or completely overhauled. Even when the JSP secured passage of such legislation in the upper house, it failed to come forward with timely, fiscally responsible substitute tax measures. Instead, the Socialists said such measures would be forthcoming after lower house action to abolish the tax (see JEI Report No. 38B, October 6, 1989).

This strategy was not well-conceived and highlighted the party's inexperience in effectively utilizing its new leverage as the dominant force in a Diet chamber. Although the upper house measure was sure to meet defeat in the lower house, the JSP missed an invaluable opportunity to negotiate a compromise

[3] Matsuzaki, op. cit., p. 9.

[4] Toshihiro Ando, "Doi Nay-Saying Is No Substitute For Policymaking," Japan Economic Journal, September 29, 1990, p. 9.

[5] Tawara et. al., op. cit., p. 15.

with the ruling party. Had the JSP chosen to cooperate rather than adopting a rigid stand, it might have realized even greater reductions or exemptions to the tax.

More important, the Socialists would have demonstrated to the electorate that their party could bridge ideological differences among the various parties, a negotiating skill necessary for leadership in a multiparty system of government. The JSP's by-then familiar refrain that the tax should be abolished apparently ended up disillusioning a plurality of voters about the largest opposition party's leadership abilities.

The other two noncommunist opposition parties, Komeito and the DSP (whose views on most policy matters actually are much closer to the LDP than the JSP), were equally at fault for failing to offer voters well-conceived policy alternatives. On the consumption tax both the DSP and Komeito parroted the JSP's line. It was not until after they incurred substantial losses in the lower house elections that they agreed to negotiate with the ruling party on a compromise tax plan.

The views of these two parties on defense and foreign policy are very much in line with the ruling party's (see JEI Report No. 41A, October 28, 1988). The only area where they effectively could make a distinctive mark and prove to voters that they could provide leadership alternatives to the JSP and the LDP is in domestic policy. On the consumption tax, in particular, their decisions to throw their lots in with the Socialists proved disastrous, as seen by their significant lower house losses.

No Clear Ideology - The opposition parties present a fractured image of being in the throes of ideological change, which no doubt confuses the electorate. While they appear to perceive a need to adapt their principles and policies to address Japan's emergence as a global power, resistance to this transition is strong.

The JSP, in particular, appears to be suffering from an identity crisis of sorts. Kotaro Tawara, an editorial writer for Sankei Shimbun, has observed that the Socialists in reality have been retreating from the principles that have guided their party over the 45 years since World War II. "What they stand for wasn't too clear in the 1989 election, and it was even less clear [in the February 1990 elections]," he has stated. "They haven't come up with anything to replace their former principles, which, though doctrinaire and unrealistic, at least provided them with an identity."[6]

The JSP's confusion as to where it should be headed ideologically is especially apparent in the defense area. The Socialists historically have argued for abolishing the U.S.-Japan Mutual Security Treaty and dismantling Japan's Self-Defense Forces. (The DSP and Komeito, as implied above, have supported Japan's defense relationship with the United States and the maintenance of defensive military forces.) When it became apparent that leadership might be within its grasp following the upper house contests, the JSP began to soften its stance, conceding that it is not "realistic to think of an overnight [abolition] of the Self-Defense Forces."

[6] Tawara et. al., op. cit., p. 15.

At the party's convention this past April the JSP agreed to support maintenance of the U.S.-Japan defense treaty. Another significant shift was its decision to delete the phrase "achievement of Socialist revolution" from its platform in an effort to dispel possible suspicion among the Japanese people that the party intends to "foment socialist revolution" (see JEI Report No. 35B, September 15, 1989). At least in these two areas the Socialists actually may be moving more toward the center of Japan's political spectrum. (Judging by the public opposition to greater Japanese involvement in and support for multilateral peacekeeping efforts in the Persian Gulf, some of the JSP's apparently evolving positions now may appeal to a broader cross section of voters than perhaps even they recognize.) However, the JSP does not appear to be exercising control over its destiny and instead is proceeding with this philosophical shift in a piecemeal, reactive manner.

The DSP also is groping for direction, fearing that no matter which way it leans it will bring about its own demise. The DSP, whose original members constituted the conservative faction of the JSP until they split from the Socialists in 1959, traditionally has served as a buffer between the Socialists and the Liberal Democrats. In the past DSP drew a large portion of its candidates and constituent support from Domei, a group of trade unions that principally represent the private sector (see JEI Report No. 41A, October 28, 1988). The 1987 absorption of Domei into Rengo (a confederation of trade unions) eliminated an important fund-raising capability and support base for the party. With Japan's emergence as a global economic power -- and the Socialists apparent move toward the center -- the need for a political middle ground and, thus, the DSP's raison d'etre have decreased significantly.

Following its loss of seats in the upper house elections, the DSP tried to attach itself to the coattails of Ms. Doi's party in an effort to build its lower house representation. But with the stinging loss of 12 seats in the February elections, the Democratic Socialists subsequently have distanced themselves from the JSP. While the JSP's potential "checking" influence on the ruling party may have prompted voters to skip over the DSP in February, the party's increasing lack of differentiation from the LDP and even the JSP on a wide range of issues also probably left voters without any clear impression of what this party could do for them.

Despite attempts by its leadership to decouple Komeito from its founding by a religious group (see JEI Report No. 41A, October 28, 1988), the party continues to attract a core of voters drawn to the party's Buddhist background. The political ideology of Komeito, which also attempted to utilize JSP coattails in the February lower house elections, is unclear, since the party has courted both the left and the right. Essentially, Komeito's strategy is aimed at achieving governing experience. That the party, on the one hand, can fall in line with the JSP on the consumption tax, while, on the other hand, talk of forming an issue-by-issue coalition with the LDP, does not seem to bother its core of voters, who consistently appear devoted to the party's religious roots.

The Japan Communist Party, while not confused about its ideology, suffers from guilt by association. The party has virtually no ties with the Soviet Communist Party and has distanced itself from the Chinese Communist Party. Nevertheless, the JCP incurred electoral losses in both the upper house and the lower house due to the public's negative reaction to Beijing's repressive tactics toward prodemocracy advocates as well as developments in Eastern Europe.

The view of communism as an ideology is seen in Japan -- and in more and more countries -- as unviable.

At its 19th annual convention this past July, however, the JCP resisted calls from both inside and outside the party to effect the sort of changes undertaken by the communist parties in the Soviet Union and Eastern Europe. Despite losing 11 of its 27 seats in the lower house, the JCP congratulated itself for winning some 5.2 million votes nationwide, contending that it obtained "as many votes as before [even though] other parties harshly criticized our party by citing situations in Eastern Europe and comparing them with the JCP."

Interparty Divisiveness - Opposition party efforts to unseat the ruling party also have been undermined by the inability of these groups to form a working coalition. Although the four major opposition parties convened a special summit in the spring of 1989 ostensibly to lay the foundation for a coalition that could take on the LDP, organizational problems and personality differences have stood in the way of unity. The JCP refuses to cooperate with any other party. Persistent ideological cleavages within the JSP itself have complicated efforts to find a common ground.

Previously, policy disagreements impeded cooperation among the three main noncommunist opposition parties. As mentioned, the JSP for many years staunchly opposed the U.S.-Japan security treaty, a stance at odds with the DSP and Komeito. The noncommunist opposition parties also have not seen eye-to-eye on such foreign policy issues as relations with North Korea and South Korea. (The JSP historically has favored normalizing relations with Pyongyang, which the DSP and Komeito oppose.) Another area of divergence is maintenance of Japan's three-point nonnuclear policy -- that is, not to possess, manufacture or permit the introduction of nuclear weapons into Japan. The Socialists believe this policy should be tightened and that Japan should reduce its reliance on nuclear power; the two centrist parties disagree.

The JSP's left wing, in particular, persistently has blocked efforts to work out these disagreements. Rather than forming a united front by pooling their resources and developing a coordinated election strategy, the four major opposition parties campaigned on their own in the lower house races. In effect, they competed with each other as much as with the LDP. The largest opposition party came out somewhat ahead, but all four might have fared better in February had they agreed to cooperate with each other.

Other Lost Opportunities

Nine months after their disappointing performance in the lower house elections, the opposition parties still appear unable to correct the mistakes that have limited their ability to challenge the LDP's rule. That the DSP and Komeito continue to grope for direction is somewhat understandable in light of their weakened strength. But the JSP -- which has not enjoyed its current parliamentary clout since the late 1960s -- continues to behave like a member of the "permanent opposition" rather than a party capable of leading Japan into a new era. The Socialists appear unable to forge a meaningful, alternative policy agenda. As one commentator noted: "The [JSP's] slogan, 'a party capable of governing the nation,' is not being fulfilled, and the JSP may even be accused of abandoning its responsibilities as the largest opposition party."[7]

[7] Ando, op. cit.

Such a perception may be behind the Socialists' more recent difficulties at the polls. Although the JSP won an upper house by-election in Fukuoka prefecture this past June, it has lost two subsequent upper house by-elections to the LDP. The JSP's November loss in Aichi prefecture and its December defeat in Niigata prefecture were significant because both contests were widely viewed as referendums on the LDP's ability to govern, coming as they did after the ruling party proposed an unpopular measure to dispatch Self-Defense Forces personnel overseas to assist United Nations peacekeeping activities (see JEI Report No. 43B, November 9, 1990).

The Socialists flat out opposed the proposed U.N. Peace Cooperation Law on the grounds that dispatching SDF personnel abroad, even in nonmilitary capacities, is unconstitutional. As with their approach to tax reform, the rigidity of the JSP's opposition did not allow room for compromise or a chance to propose an alternative. Ironically, an important plank of the Socialists' foreign policy platform has been to utilize the United Nations as a forum for resolving regional and global conflicts. The JSP possibly could have become more directly engaged in the policymaking process -- and emphasized its U.N. support -- if it had countered with a proposal that Japan dispatch a volunteer peace cooperation team minus SDF personnel. As it turns out, the ruling party probably will pursue this alternative since it was forced to withdraw its original proposal (see JEI Report No. 44B, November 16, 1990). Moreover, the Socialists could have drawn support from elements within the ruling party itself that opposed the peace cooperation plan, further enhancing a leadership image.

The Socialists also have been upstaged by the Liberal Democrats on the issue of Japan's relations with North Korea. Until recently the JSP was the only major political party to advocate a tilt toward the north in Japan's Korea policy. But when North Korean President Kim Il Sung decided to broach the possible establishment of diplomatic relations between Tokyo and Pyongyang during a late September visit to North Korea by a joint LDP-JSP delegation, he made the overture to veteran LDP member Shin Kanemaru rather than the group's other coleader, JSP vice chairman Makoto Tanabe (see JEI Report No. 38B, October 5, 1990). Prime Minister Toshiki Kaifu's favorable response to Pyongyang's offer left the JSP on the sidelines with nothing to show for the years in which it had kept channels of communication open between the two countries.

Another indication of the Socialist Party's leadership shortcomings was the decision in October by three upper house Tax Party members to join the ruling party. According to one of the trio, the three legislators decided to align with the LDP so they could "tackle the tax issue through the ruling party." The JSP apparently did not inspire these three legislators' confidence in its ability to play a meaningful role in the tax debate.

The JSP's apparent inability to break out of a reactive mode may be due to its years of operating in an LDP-dominated political system. Some political analysts suggest that the Socialists' 30-odd-year status as an opposition party has had an enervating impact. In that view the minority position has tended to perpetuate the party's view of itself as stagnant and sapped all inspiration to develop coherent, forward-looking policies.[8] Until recently JSP members had little incentive to play an active role in policy development or in building the party's national organization. Even after its upper house upset, the largest opposition party still had only a handful of economists and foreign policy analysts on its headquarters staff devoted to policy analysis and development. The LDP, in comparison, has numerous committees and task forces devoted to policy formulation. By virtue of its years at the helm, the ruling party also knows how to tap the bureaucracy for policy expertise.

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[8] Gerald Curtis, The Japanese Way of Politics (New York: Columbia University Press, 1988), p. 121.

Judging by the way the Socialists have been dealing with the LDP-backed plan to change the electoral system, the opposition party may bungle another opportunity to enhance its political stature. As will be discussed below, the ruling party's plan to do away with the current multiseat electoral system in favor of one that combines both single-seat and proportional representation will hurt everyone -- but especially the opposition parties. Not surprisingly, the JSP persistently has opposed the change. One analyst has asked, however, "How will [the Socialist Party] be able to reconcile such a position with [its] public commitment to seizing power [which obviously requires a change]?"[9] The JSP once again may be setting itself up to play nothing more than a reactive role in the policy debate.

Will Electoral Reform Shake Things Up?

Prime Minister Kaifu earlier this year said he would stake his administration on enactment of a plan to reform Japan's electoral system. The most recent drive for political reform, as it commonly is called, is an outgrowth of the Recruit influence-peddling affair. That scandal highlighted one of the basic realities of the lower house's multiseat electoral system, wherein three to five candidates are elected to represent each district. This form of representation requires a candidate to raise extraordinary sums of money to wage what essentially is a "personality contest."

The money-centered nature of politics in Japan opens the system up to abuse in the absence of loophole-proof limits on campaign contributions. All of the noncommunist parties had at least one member who was alleged to have received shares in Recruit Cosmos, Co., Ltd. in 1984-86 before the Recruit subsidiary's stock became available in the over-the-counter market. A company's offering of preflotation shares as a political contribution at that time was not uncommon and not illegal in Japan. However, Recruit's activities gave the appearance of impropriety because of the huge amounts of stock sold (some 2,016,000 shares went to approximately 159 people) and the enormous profits each purchaser realized when the real estate firm went public in 1986. As was later revealed, Hiromasa Ezoe, Recruit's founder and former chairman, strategically targeted these campaign "gifts" in an effort to penetrate the LDP's close ties to established big business and, in turn, buy political influence.

The LDP, which had many leading members who were prominent recipients of Mr. Ezoe's apparent largesse, was hurt badly by these revelations. The Recruit affair sorely offended the public's sense of what is just and fair. In early 1989 voters turned to the polls to take out their anger and disenchantment with what they viewed as the ruling party's corruption. The LDP, in an effort to improve its image with the electorate and prove its sincere desire to "clean up" Japanese politics, committed itself in the spring of 1989 to changing the system. Former Prime Minister Noboru Takeshita's resignation in April 1989 to accept responsibility for the extent of his party's involvement with Mr. Ezoe, gave additional impetus to LDP efforts for electoral system reforms.

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[9] Ando, op. cit.

In late November the LDP put the finishing touches on a reform proposal that it plans to submit to the Diet for consideration during the current regular session. Under the ruling party's plan the number of lower house seats would be cut from 512 to 471. These 471 seats would be filled by 300 members representing single-seat constituencies and 171 elected according to a proportional representation system. Thus, each voter would cast two ballots: one for a representative to fill the seat allotted under the single-seat apportionment, the other for a political party. These "proportional" seats would be distributed among the parties according to the number of votes each party received in each electoral region. The representative would be whoever topped the cutoff figure on the parties' lists of potential delegates.

Virtually all pundits agree that the LDP would win heavily under the proposed system; the JSP, they say, probably would suffer big losses, and the smaller parties could disappear because there would be fewer opportunities for voters to select LDP-alternative candidates. Why then do an estimated one-quarter of LDP Diet members object to the plan? For one, electoral districts would be eliminated. Junior LDP members also are concerned that they may be told to run for a proportional seat or in a district with which they have no political ties. (The proposed reform apparently does not address the U.S. equivalent of carpetbagging.) In addition, there is a lot of uncertainty as to whether or when a member will be designated an "official party candidate" and whether an abundance of money still will be needed, either to campaign to be named an official party candidate or to campaign for a single seat. In short, enactment of the proposed electoral reform is not assured; Mr. Kaifu will face stiff resistance from his own party as well as the political opposition.

If the prime minister is successful in enacting this plan, however, Japan's political parties may be shaken up. A U.S.-style two-party system could evolve, with the LDP dominating the conservative end of the spectrum and the JSP occupying the liberal end. The DSP, Komeito and small, single-issue parties may find that they have no choice but to enter one or the other folds.

Outlook for Possible Realignments

Even if Mr. Kaifu's electoral plan does not become law, there appears to be some potential for party realignment. The Socialists' more recent, softer line on defense issues suggests that the JSP's left wing may be losing its ability to paralyze the party. Further evidence of the party's shift toward the political center is apparent in a recently announced plan by JSP members to form a "centrist faction." Between 40 and 50 JSP Diet members are expected to join the new faction, led by Diet member Takatoshi Fujita; inaugural ceremonies are set for January 24, party sources leaked to the Japanese press in early December. "It is important to respond to the people's needs and to establish an ideal of social democracy that would help the JSP take over the government," Mr. Fujita stated.

The JSP no doubt hopes to bring DSP and Komeito members under its wing and broaden its base of popular support. Experts agree that a broader vision is imperative if the party hopes to seize control from the LDP. "The JSP's great gains in the election were due to its slipping away from leftist ideology to a more centrist position," contends Kimihiro Masamura of Senshu University. "But further gains can't be expected from this sort of unsystematic slipping toward the middle of the road. The Socialists will have to reorganize themselves into a truly centrist party if they want to pick up even more votes."[10]

Even with the JSP's emerging shift in political ideology, the DSP and Komeito do not appear interested in aligning with the Socialists in the hope of someday ruling the country. The JSP's arrogance about its 58-seat gain in the House of Representatives immediately following the lower house elections was instrumental in pushing the two centrist parties toward the political right. Indirectly suggesting that the weakened Komeito and DSP had no choice but to follow the Socialists' party line, JSP secretary general Tsuruo Yamaguchi declared last March that "the JSP's gains in the [lower house] election indicate that the voters supported the policies of the JSP. . . . [O]ur bargaining power with the LDP depends on our unity as a majority force in the upper house against the LDP's control of the lower chamber."

Yuichi Ichikawa, secretary general of Komeito, rebutted that while "opposition unity may be beneficial for the JSP, we are not an auxiliary force for [that party]." At Komeito's annual convention in April chairman Koshiro Ishida formally distanced the party from the JSP, calling for a freeze on talks to forge an opposition party coalition. The need for a third "pole" in addition to the LDP and the JSP is greater than ever, Mr. Ishida reportedly told party delegates.

In the intervening months Komeito -- which bills itself as the Clean Government Party -- has gravitated significantly to the right of its centrist "pole" and indicated that it will cooperate with the ruling party on specific issues. But the small opposition party is not considering forming a coalition government with the LDP, Mr. Ichikawa has clarified. Komeito's desire to become a more significant actor in the governing process, nevertheless, is apparent from its chairman's remark in early December that a "political atmosphere for a coalition between Komeito and the LDP will improve if the [ruling party] goes ahead with [plans to] reform the political system and stops raising election funds from financial circles."

As mentioned, the DSP also has tried to dissociate itself from the Socialist camp. Former DSP chairman Eiichi Nagasue, who favored closer relations with the JSP, was forced to resign to assume responsibility for his party's losses in the February lower house elections. The DSP's current chief, Keigo Ouchi, has reversed this line. The party has stopped short of proposing any sort of coalition or issue-by-issue cooperation with the ruling party, however, for fear of finding itself absorbed by the LDP. There is a view that in an effort of self-preservation the DSP again might return to a loose alliance with the JSP.[11] With the JSP's apparent movement toward the political center, this may not be an unrealistic scenario.

The ruling party itself may find a seriously eroded base of support depending on how it handles key domestic and international issues. Although the Uruguay Round of multilateral trade negotiations is stopped in its tracks over

[10] Tawara et. al., op. cit., p. 15.

[11] Kyoko Shiotani, "Caught In The Middle," Far Eastern Economic Review, July 12, 1990, p. 20.

agricultural trade disputes and possibly derailed (see JEI Report No. 48B, December 21, 1990), Japan's political parties are well aware that the United States and certain other trading partners want Tokyo to open its rice market at least part way to imports. So far Komeito is the only party to state outright that Japan's ban on rice imports should be lifted. Both the JSP and the LDP have opposed liberalization of this market. It is always possible that the Kaifu administration will ease Japan's stand on rice in a bid to revive the Uruguay Round, which, if successful, would benefit Japanese business interests. This is unlikely, however, because such a move could spark a voter backlash.

The LDP could be in trouble with a large bloc of voters on another issue. The party's recent proposal for a national land-holding tax, a levy ostensibly designed to brake spiraling real estate prices in Japan, owed its final shape to heavy pressure from agricultural and business interests (see JEI Report No. 47B, December 14, 1990). The government's tax advisory body had advocated a much stiffer property tax and did not envision the extensive exceptions that the LDP ended up proposing for businesses and farmers. (The party's measure would hit only an estimated 50,000 to 60,000 property owners). As a result of the LDP's watered-down plan, the middle-income "salary man," who must contend with cramped and overpriced rental housing, may turn away from the ruling party in disgust.

Events in the Persian Gulf also may challenge the LDP-led government. If war breaks out in the Middle East, Washington and other Western allies undoubtedly will pressure Tokyo to provide more than monetary assistance. A U.N. peace cooperation team without SDF personnel might not be deemed an acceptable contribution. If Mr. Kaifu, in an effort to respond to allied demands, is perceived as forcing Japan to exceed its 45-year-old self-defense mission, this too could trigger an anti-LDP reaction.

The opposition parties could benefit from these or any similar turn of events. Equally possible is that these policy-related stresses could cause the ruling party to splinter, creating potential coalition parties for any one of the political opposition.

The early April 1991 unified local elections, involving the selection of 13 of Japan's 47 prefectural governors, one mayor and other local assembly members, should provide additional clues as to how Japan's political landscape is evolving. In the meantime, according to political columnist Minoru Tada, "The political situation is likely to continue zigzagging with no sign of stability on the horizon."[12]

[12] Minoru Tada, "Opposition Coalition Dead," The Japan Times, May 4, 1990.

For further information, contact Barbara Wanner.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published December 28, 1990 and January 4, 1991 because of the Christmas Day and the New Year's Day holidays. The next issue will be dated January 11, 1991.

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JEI

REPORT

A Two-Part Report: A and B

NO. 48B
December 21, 1990

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GATT Meetings Fail To Resolve Impasse

A narrow view might suggest that Tokyo would be pleased with the lack of an outcome in the latest Uruguay Round talks. Meetings in Brussels, which had been intended as a wrap-up session involving high-level trade negotiators from 107 countries, ended December 7 after four days. There were no agreements in any of the 15 negotiating areas and, in particular, no decision to liberalize world trade in agriculture. As of late December further talks appears likely but not guaranteed; Arthur Dunkel, director general of the General Agreement on Tariffs and Trade, has called for an ambassador-level meeting January 15 to get the multilateral trade negotiations process moving again. With the possibility that subsequent Uruguay Round meetings, if any, could prove just as inconclusive as those in Brussels, Tokyo appears increasingly likely to prevail in maintaining its restrictions on rice imports after more than four years of negotiations. Yet commentators from the Far East to Europe seem to feel that, while perhaps winning a battle, Japan is on the verge of losing the war. They have several arguments.

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To plug the weak spots of the 1988 accord the U.S. team, headed by Under Secretary of Commerce for International Trade Michael Farren, proposed several changes: expansion of the agreement to cover all public works projects funded by the central government; inclusion of subcontracts whenever a primary contract is covered by the agreement; implementation of a dispute-handling mechanism that could reopen bids or thoroughly investigate disputed contracts; elimination of rules that encourage foreign firms to form joint ventures with domestic companies to qualify to bid; provision of more information on new projects to foreign firms on a timelier basis; and elucidation of all decisions made under the designated bidder system. The American side let it be known that, short of achieving universal access, it would settle for a broad description of projects that the pact would cover (or at least a longer list of specific projects). Administration officials hinted strongly that a positive assessment of the 1988 pact hinged on reopening the people-mover bid.

Tokyo rejected these proposals, arguing that the 1988 agreement had a limited dual intent: to help foreign firms gain experience with Japan's designated bidder system and to allow them to establish a track record and reputation in Japan. The agreement is a transitory measure, according to Japanese officials; since it will become unnecessary in a few years, they say, no expansion is needed. The Japanese delegation was amenable to improving the transparency of the system, apparently grateful that the American side had dropped its absolute opposition to Japan's designated bidder approach.

KIAC's management muddied the outlook for the talks with two actions. First, KIAC rebuffed American complaints about the people-mover project by signing a Y4.7 billion ($34.8 million at Y135=$1.00) contract December 7 with the Japanese consortium that underbid the American-West German team of AEG Westinghouse Transportation Systems Inc. Also, as the two days of bilateral talks got under way December 12, KIAC announced that an American-Japanese-West German team had won the competition to build the airport's baggage-handling system. This contract was awarded under the exact same bidding procedures that the United States claimed were inappropriate for the people-mover system. Austin Co. of Cleveland Ohio, Beumer Maschinenfabrik KG and Kawasaki Heavy Industries, Ltd. spent four years and more than $1 million preparing their joint bid for the estimated $50 million contract.

The Bush administration has set a January 15, 1991 deadline for evaluating the 1988 accord. Trade officials point out that under the 1988 trade act the U.S. Trade Representative must decide on a course of action by May 1, 1991. Whether the two sides can bridge their differences in so short a time is unclear.

Jon Choy

New Five-Year Defense Plan To Feature Smaller Spending Increases

Reflecting expectations of an improved security environment in the post-Cold War era, Japan's new five-year defense plan probably will feature smaller spending increases than the current version, Japanese government sources have indicated. At JEI press time the National Security Council, a defense-centered panel composed of Prime Minister Toshiki Kaifu and selected cabinet officials, was finalizing the FY 1991-FY 1995 Medium-Term Defense Plan, which is expected to involve expenditures of about Y23 trillion ($170.4 billion at Y135=$1.00). According to news sources, the new plan will limit annual increases in spending to just under 3 percent in the five years starting April 1, 1991. The plan will be reviewed after three years to make adjustments in spending, equipment procurement and personnel in line with changes in the global security environment.

Japan's defense budget has grown steadily during the past decade, increasing at an average annual rate of 6.4 percent (see Table). Some analysts estimate that this year Japan surpassed the United Kingdom to rank third in military expenditures behind the United States and the Soviet Union. Despite pressure from Washington for Japan and other allies to assume more of the mutual defense burden, the days of high-growth military budgets may be over, judging by recent comments from Japanese government officials. "There is a general sense that there is no longer a need for th[at] kind of increase," a Japanese diplomat recently was quoted as saying. Mr. Kaifu's December 12 comments before the Diet that the new defense plan will follow the "spirit" of the 1976 National Defense Program Outline, an overarching plan that stipulates a moderate defense capability in peacetime, suggests that the government favors braking the recent growth of defense spending.

Japan's Defense Budget, FY 1980-FY 1990

(in billions of yen)

Fiscal Year	Initial Budget	Percent Change	Ratio to GNP
1980	Y2,230.2	6.5%	0.90%
1981	2,400.0	7.6	0.91
1982	2,586.1	7.8	0.93
1983	2,754.2	6.5	0.98
1984	2,934.7	6.6	0.99
1985	3,137.2	6.9	0.99
1986	3,343.6	6.6	0.99
1987	3,517.4	5.2	1.00
1988	3,700.3	5.2	1.013
1989	3,919.8	5.9	1.006
1990	4,159.0	6.1	0.99

Source: Japan Defense Agency

This news no doubt will disappoint Pentagon officials who, over the years, have urged Tokyo to at least maintain the 6 percent-plus spending increases that help Japan satisfy certain self-defense roles and missions. The reaction on Capitol Hill probably will be more vitriolic, depending on how legislators interpret Tokyo's future burdensharing plans. Before adjourning in October Congress passed a nonbinding resolution that called on Japan to assume 100 percent of the yen costs associated with stationing U.S. troops there. Tokyo's failure to do so, the resolution stated, would precipitate a "rapid" withdrawal of American forces from Japan. The Japanese government's decision to rein in future defense expenditures may be interpreted by many American legislators as evidence of Japan's unwillingness to assume the attendant political and security-related responsibilities of a global power.

In this regard, the timing of discussions on Japan's new defense plan is especially unfortunate. Last month Mr. Kaifu was forced to withdraw from the Diet a bill that would have authorized the dispatch overseas of Self-Defense Forces to assist peacekeeping activities under the United Nations' aegis (see JEI Report No. 44B, November 16, 1990). Senior Liberal Democratic Party officials, in consultation with the relevant bureaucracies, crafted the plan in response to pressure from Washington and other allies that Japan provide more than money to support multilateral efforts aimed at resolving the crisis in the Persian Gulf. The prime minister, however, was unable to win enough backing for the plan from members of his own party and had little or no support from the opposition parties. The main argument against the plan was that it exceeded Japan's 45-year-old government policy of not dispatching overseas any armed forces or participating in collective defense arrangements. Many in Congress have charged that Tokyo simply is hiding behind its "peace constitution," on which the long-standing government policy is based, rather than putting itself at risk with the majority of its allies in protesting Saddam Hussein's invasion of Kuwait.

Apparently anticipating this firestorm, Japanese officials told U.S. defense dignitaries visiting Tokyo December 10 that, despite plans to hold down spending hikes, Tokyo gradually will increase its share of the financial burden for supporting the approximately 50,000 U.S. troops stationed at over 100 military facilities in the Japanese archipelago. Beginning in FY 1991, the government proposed, Japan will cover 50 percent of the roughly $6 billion annual cost of maintaining U.S. forces in Japan, a 10 percentage point increase. During the course of the next five years this will amount to an additional Y90 billion ($666.7 million) for the salaries of Japanese employees at U.S. bases and specified maintenance costs. (The FY 1990 budget allocated Y320 billion or $2.4 billion for host-nation support.)

The two sides reportedly did not reach a final agreement at the early December meetings; Washington wants Tokyo to cover more than charges for electricity, gas and water, which Japan had agreed to add to its costs. U.S. defense officials evidently stressed that unless Tokyo substantially boosts host-nation support in the coming years -- that is to say, significantly more than the 10-point share increase now envisioned -- congressional sentiments on burdensharing could harden; this was viewed by some analysts as a hint that the new Congress might try to pass a binding measure requiring massive troop pullouts from Japan. Washington also asked that Tokyo expand its host-nation support before next April due to the squeeze placed on the Pentagon's budget by the deployment of American troops to the Persian Gulf. Japanese negotiators were said to have agreed in principle to advanced implementation, adding that the green light still has to come from the Ministry of Finance.

In terms of equipment procurement the scaled-back FY 1991-FY 1995 defense plan may mean that Japan Defense Agency officials will be unable to get all that they had hoped for. During preliminary discussions of the plan this past summer JDA had included on its "wish list" a number of items that, for the most part, would be purchased off-the-shelf from the United States. These included: AWACS (airborne warning and control system) aircraft, the multiple-launch rocket system, tanker-refueling aircraft and Aegis systems. The defense agency also was looking to upgrade living and working conditions for SDF personnel and to establish a new 2,000-person headquarters for gathering and analyzing intelligence data (see JEI Report No. 35A, September 14, 1990).

During the early December meetings with their U.S. counterparts, however, Japanese defense officials said that Japan would strive to buy four AWACS planes during the plan period. (At one point there reportedly was talk of Tokyo purchasing 12 of these sophisticated early warning aircraft.) The Pentagon has encouraged the AWACS purchases and the acquisitions of other sophisticated equipment so Japan can better realize its goal of defending the area 1,000 nautical miles east and south of the home islands. But since these planes cost approximately Y20 billion ($184.2 million) each, Tokyo may have to slow down its acquisition of other frontline equipment, such as tanks, destroyers and fighter aircraft, particularly when faced with smaller defense spending hikes, Japanese officials have indicated. One item on the "wish list" that probably will be dropped is the tanker-refueling aircraft. Purchases of the MLRS and Aegis at this stage are still part of the plan.

Personnel also may be cut due to budgetary constraints as well as a reassessment of Japan's comprehensive defense program. The National Security Council at JEI press time also was expected to indicate whether the 1976 National Defense Program Outline should be reassessed to bring it in line with post-Cold War developments. The current outline was drawn up in a bipolar context. Japanese defense planners may find that the self-defense mission pursued under the deterrence-oriented U.S.-Japan Mutual Security Treaty is neither appropriate nor effective in responding to a crisis that does not involve the threat of a Soviet attack. The problems Tokyo encountered in considering its response to the Persian Gulf crisis would appear to point to some inadequacies regarding the current defense framework.

If the National Security Council does agree to an evaluation, defense planners would undertake a comprehensive review, beginning next April, of the Ground, Maritime and Air Self-Defense Forces, assessing their manpower strengths and their unit formation. An inventory of warships, fighter planes and other major equipment presumably would be done, as well, to discern where qualitative improvements or replacements are needed.

Barbara Wanner

Notes

Supplemental Budget - A Y2.3 trillion ($17 billion at Y135=$1.00) additional spending package for FY 1990 survived the Diet's legislative process and became effective December 17. The lower house of the Diet, which is controlled by the ruling Liberal Democratic Party, approved the measure December 13. The House of Councillors, which is controlled by the opposition parties, considered and then rejected the bill December 17. After delegations from the two houses were unable to negotiate a compromise, the lower house invoked its constitutional primacy on spending measures, making the bill law.

The supplemental budget, which is small compared to the extra spending authorized in FY 1989, mainly contains money for disaster relief and government employee salary hikes. Of particular interest to Washington, however, is about Y130 billion ($963 million) in financial support for the U.S.-led multinational peacekeeping force in the Persian Gulf (see JEI Report No. 46B, December 7, 1990). This special appropriation explains why action on the supplemental budget was completed several months ahead of the normal schedule. The quick action

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Government Sees Slower Economic Growth In FY 1991

Japan's economy will stay on an expansion path in the fiscal year that begins April 1 but will be unable to maintain the heady growth that has been its hallmark since pulling out of a slowdown in late 1986. That seems to be the lesson contained in Tokyo's latest economic outlook, accepted by the cabinet December 20. For the coming fiscal year the Economic Planning Agency expects that inflation-adjusted gross national product will grow 3.8 percent (see Table 1). American policymakers would love to have the U.S. economy turn in a performance nearly that good. To Tokyo, however, the figures are almost small enough to be termed an economic downturn and, if realized, would be the lowest growth since FY 1986.

The pattern of Japan's economic growth in the coming fiscal year will be similar to recent years. As in every fiscal year since 1986 inclusive, healthy expansion of domestic demand -- expected to add 4 percentage points to overall

Table 1: Government's FY 1991 Outlook for Real Gross National Product

	Actual			Estimated	Projected
	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Real Gross National Product	4.9%	5.9%	4.8%	5.2%	3.8%
Consumer Spending	4.1	5.5	4.1	4.2	4.1
Residential Construction	26.3	4.8	0.7	8.4	-2.7
Private Capital Spending	8.6	16.6	14.1	11.7	6.8
Trade Surplus (billions of dollars)	94.0	95.3	70.0	57.0	56.0
Current Account Surplus (billions of dollars)	$84.5	$77.3	$53.4	$32.0	$30.0
Wholesale Prices	-2.0	-0.7	3.5	2.0	-0.1
Consumer Prices	0.5	0.8	2.9	3.1	2.4
Unemployment Rate (percent)	2.8	2.4	2.2	2.2	2.2
Yen-Dollar Exchange Rate	Y138.3	Y128.3	Y142.8	Y139.3	Y128.1

Source: Economic Planning Agency

growth in the April 1991-March 1992 period -- will more than offset continued sluggishness in the external sector, which in FY 1991 is projected to shave 0.2 point off GNP growth. Consumer spending is expected to grow almost as fast as in the current fiscal year, but plant and equipment spending -- the main growth engine in recent years -- is anticipated to expand at a much slower rate.

As an official set of numbers used as part of the budget process, the economic outlook typically generates squabbling among government agencies. The Ministry of International Trade and Industry consistently has held out for higher projected growth rates, while the Ministry of Finance usually favors one lower than the eventual compromise engineered by the Economic Planning Agency. To the extent that MOF is successful in getting a lower figure accepted than would otherwise be the case, it has to worry less about government borrowing. Should growth end up higher than expected, the deficit ends up lower than anticipated, a development about which few MOF officials would fret.

This argument would suggest that the figures have a downward bias. The numbers for FY 1990 support that view; the government's original projection of 4 percent real economic growth now looks extremely pessimistic next to the current expectation of a 5.2 percent gain or even year-old private forecasts of 4.9 percent growth. (For details of EPA's original outlook and private forecasts for FY 1990, see JEI Report No. 8A, February 23, 1990.)

If private forecasts are taken as a benchmark, however, FY 1991 promises to be worse, not better, than the government expects. On average, a cross section of business forecasters expect real growth of 3.6 percent in FY 1991 (see

Table 2). Some recent projections are considerably more pessimistic than even this average. For example, the Japan Economic Research Center in late December projected growth of only 2.9 percent in the coming fiscal year. Such a rate would equal that of FY 1986 and could imply rising unemployment; in contrast, the official outlook anticipates that joblessness will remain constant at 2.2 percent.

Table 2: Selected Private Economic Forecasts for FY 1991

(percent change unless otherwise indicated)

	Real GNP	Consumer Spending	Real Capital Spending	Current Account Surplus*
Research Institute of the National Economy	4.2%	4.6%	7.8%	$43.2
Daiwa Institute of Research	4.0	4.2	5.9	38.0
Kyowa Bank, Ltd.	4.0	4.4	6.9	42.8
Bank of Tokyo, Ltd.	3.8	4.1	7.5	36.2
Sanwa Research Institute	3.5	3.7	5.5	41.1
NLI Research Institute	3.4	4.3	6.8	35.0
Fuji Bank, Ltd.	3.3	3.9	5.8	16.0
Tokai Bank, Ltd.	3.0	4.1	5.5	31.0
Japan Economic Research Center	2.9	3.8	5.1	49.5
Average Forecast	3.6	4.1	6.3	37.0

*In billions of dollars.

JERC's pessimism notwithstanding, Japan's economy in the next 12 months is likely to remain relatively healthy when compared to those of other industrial nations. The Organization for Economic Cooperation and Development expects Japanese growth to decelerate markedly in 1991. According to the OECD's figures, Japan's economy recorded a sizzling 6.1 percent inflation-adjusted gain in calendar 1990, but growth will cool to a "mere" 3.7 percent expansion in 1991. OECD says that the U.S. economy grew by a mere 1 percent in real terms last year and will manage only a 0.9 percent rise this year. In all, real economic growth in the 24 industrial nations that comprise the OECD's membership is expected to fall from the 2.8 percent averaged in 1990 to 2 percent in 1991. The OECD's message appears to be that growth in Japan, while it will slow more sharply than elsewhere, will remain higher than in most other OECD countries. If the OECD is right, a year from now domestic concerns about Japan's sluggish economy could surprise foreign observers who might wonder how Japan manages to do so well.

Douglas Ostrom

FY 1991 Budget Boosts Spending

Responding to both domestic and foreign pressures, the cabinet of Prime Minister Toshiki Kaifu in late December quickly hammered out a spending plan for the year beginning April 1, 1991 that boasts solid increases in outlays for public works, defense and foreign aid. The Ministry of Finance, however, kept a firm hand on the throttle in its drive to control the budget deficit and the outstanding national debt, but the pace will not be as slow as some MOF analysts had hoped. Expanded overall discretionary spending in both the general account and the Fiscal Investment and Loan Program actually should translate into a mildly stimulative fiscal policy in FY 1991, according to a MOF spokesman.

Under the budget plan adopted by the cabinet December 29 general account spending in FY 1991 is expected to grow 6.2 percent to more than Y70.3 trillion ($520.7 billion at Y135=$1.00), based on a 7.3 percent increase in mandatory outlays and a 5.3 percent rise in discretionary expenditures (see Table 1). Compared with FY 1990's initial budget, the government's plan for FY 1991 shows important shifts in spending patterns. A narrowing of the growth differential between discretionary and mandatory outlays is clear. In the FY 1990 initial budget nondiscretionary spending easily bested its counterpart, 17.2 percent to 3.9 percent. In the FY 1991 version the gap is modest. The upshot is that despite lower overall growth in projected general account outlays (6.2 percent in FY 1991 versus 9.7 percent in FY 1990), Tokyo hopes to expand discretionary spending at a faster rate in the coming fiscal year than in the current one.

Table 1: Summary of General Account Outlays, FY 1990-FY 1991

(in billions of yen)

	Initial FY 1990	Initial FY 1991	Change
Discretionary Items			
Social Security	Y11,614.8	Y12,212.2	5.1%
Education and Science	5,112.9	5,394.4	5.5
Pensions	1,837.5	1,808.4	-1.6
Defense	4,159.3	4,387.0	5.5
Economic Cooperation	784.5	845.9	7.8
Public Works	6,148.0	6,521.5	6.1
Disaster Reconstruction	66.7	68.2	2.2
Small Business Measures	194.3	195.0	0.3
Food Control Programs	395.2	373.2	-5.6
Energy Measures	547.6	592.1	8.1
Other	4,162.2	4,355.3	4.6
Infrastructure Investment	0.0	135.0	100.0
Reserves	350.0	350.0	0.0
Subtotal	35,373.1	37,238.2	5.3
Nondiscretionary Items			
Transfers to Local Governments	15,275.1	15,974.9	4.6
Debt Service	14,288.6	15,834.3	10.8
Transfer of NTT Proceeds to Public Works	1,300.0	1,300.0	0.0
Subtotal	30,863.7	33,109.2	7.3
Total	66,236.8	70,347.4	6.2

Important changes also are evident at the first level of spending disaggregation. Although only two categories registered declines in both initial budgets (pensions and food control programs), planned FY 1991 discretionary expenditure increases are greater overall and more evenly distributed. (See JEI Report No. 1B, January 5, 1990 for details of the initial budget for FY 1990.) Standouts include funds for energy programs (due partly to higher crude oil prices but also because of renewed interest in alternative energy development), public works projects, foreign aid and defense. (For details on the latter two, see articles in this issue.)

While it is not surprising that allocations for foreign economic cooperation and defense can be linked directly to external events, such a link also can be drawn for public works spending. Last summer Tokyo committed itself in the Structural Impediments Initiative talks with the United States to increase spending on domestic infrastructure over 10 years starting in FY 1991. At late January follow-up talks Tokyo will be able to point to a fatter public works budget in the upcoming fiscal year as proof that it is taking its SII promise seriously. A new five-year plan for infrastructure investment gives some detail to Tokyo's pledge to raise sharply public works spending (see Table 2).

Table 2: Revised FY 1991-FY 1995 Public Works Plan

(housing in thousands of units; all others in millions of yen)

	Original	Revised
Housing	6,700	7,300
Airports	Y1,920	Y3,190
Harbors	4,400	5,700
Water Supply	12,200	16,500
Sewage Treatment Facilities	1,910	2,830
Parks	3,110	5,000
Pedestrian Safety	1,485	2,015
Sidewalks	1,350	1,850
Other	135	165

Important developments also are clear in nondiscretionary spending categories for FY 1991. The growth of transfers from the central government to local governments is expected to assume a modest 4.6 percent pace in FY 1991, compared to the more active 14.3 percent slated for this fiscal year. This reflects an expected economic slowdown (see preceding article) and the consequent fall in tax receipts on which transfers are calculated. Perhaps more important to MOF budget analysts, however, is the sharp fall in the growth of interest payments on the national debt. FY 1991's projected 10.8 percent rise in debt service is well below FY 1990's initial 22.5 percent figure -- the result of the government's successful 10-year drive to cut issuance of deficit-financing bonds and finally eliminate borrowing to fund current operations. Interestingly, the government has budgeted Y1.3 trillion ($9.6 billion) in additional spending in FY 1991 funded by previous years' sales of government-held shares of Nippon Telegraph and Telephone Corp. It is not clear, however, how much longer MOF can count on this source of revenue (see JEI Report No. 45B, November 30, 1990).

On the revenue side expectations of slower economic growth in FY 1991 again have a striking impact (Table 3). Compared with the initial budget for the current fiscal year, tax and stamp receipts as well as nontax revenues both show smaller projected increases, 6.5 percent versus 13.7 percent and 22.5 percent versus 34.9 percent, respectively. The uncertainty of these forecasts increases when the contents of the government's tax package for FY 1991 is examined. Controversy over proposed property and other tax changes (see article in this issue) may prevent timely passage of the budget, much as opposition to the 3 percent consumption tax did in 1989 and 1990.

The pattern of spending in the general account is carried through to the government's second capital budget, the Fiscal Investment and Loan Program (see

Table 3: Summary of General Account Revenue Estimates, FY 1990-FY 1991

(in billions of yen)

	Initial FY 1990	Initial FY 1991	Change
Tax and Stamp Receipts	Y58,004.0	Y61,772.0	6.5%
Nontax Receipts	1,339.6	1,932.4	44.3
Proceeds from Sale of NTT Shares	1,300.0	1,300.0	0.0
Bonds	5,593.2	5,343.0	-4.5
Construction	5,593.2	5,343.0	-4.5
Deficit-Financing	0.0	0.0	0.0
Total	66,273.6	70,347.4	6.2

Table 4: Fiscal Investment and Loan Program Outlays, FY 1990-FY 1991

(in billions of yen)

	Initial FY 1990		Initial FY 1991	
	Amount	Change	Amount	Change
Housing	Y8,365.9	12.1%	Y9,474.5	13.3%
Other Social Infrastructure	4,222.0	-3.4	4,293.3	1.7
Welfare	851.9	15.7	1,026.1	20.4
Education	554.1	6.5	582.4	5.1
Small Business	4,337.8	3.9	4,494.5	3.6
Agriculture	876.0	-5.2	908.2	3.7
Land Conservation and Disaster Relief	328.5	-8.2	330.6	0.6
Roads	2,700.1	4.8	2,983.2	10.5
Transportation and Communications	2,304.1	-2.4	1,468.1	-36.3
Regional Development	682.5	0.9	709.0	3.9
Industry and Technology	796.5	5.0	937.7	17.7
Trade Promotion and Economic Cooperation	1,603.0	12.9	1,898.0	18.4
Capital Utilization	6,950.0	17.2	7,700.0	10.8
Total	34,572.4	7.1	36,805.6	6.5

Table 5: Fiscal Investment and Loan Program Sources, FY 1990-FY 1991

(in billions of yen)

	Initial FY 1990		Initial FY 1991	
	Amount	Change	Amount	Change
Industrial Investment Special Account	Y64.1	-24.8%	Y65.7	2.5%
Trust Fund Bureau Fund	28,453.3	5.9	29,134.9	2.4
Postal Savings	7,200.0	-15.3	8,800.0	22.2
Pension Contributions	5,540.0	28.5	6,430.0	16.1
Other Revenues	15,713.3	11.7	13,904.9	-11.5
Postal Life Insurance Fund	6,055.0	7.9	6,305.0	4.1
Government-Guaranteed Bonds and Borrowings	2,000.0	0.0	1,900.0	-5.0
Total	36,572.4	5.8	37,405.6	2.3

Table 6: Proposed and Approved Initial FY 1991 Discretionary Outlays

(in billions of yen)

	Proposed	Approved
Social Security	Y12,176.5	Y12,212.2
Education and Science	5,327.0	5,394.4
Pensions	1,762.4	1,808.4
Defense	4,372.9	4,387.0
Economic Cooperation	829.1	845.9
Public Works	6,521.5	6,521.5
Disaster Reconstruction	68.2	68.2
Small Business Measures	192.0	195.0
Food Control Programs	373.2	373.2
Energy Measures	578.9	592.1
Other	4,451.7	4,355.3
Infrastructure Investment	135.0	135.0
Reserves	350.0	350.0
Unallocated Expenses	100.0	--

Table 4). Foreign aid and social overhead capital clearly continue to receive top priority. Perhaps somewhat disappointing from the standpoint of the Bush administration, however, is the reduction in overall FILP growth from 7.1 percent to 6.5 percent. As for sources of FILP funds (Table 5) MOF's drive to cut government borrowing holds sway here as well.

The cabinet approved the FY 1991 spending plan five days after receiving a proposed package from the Finance Ministry. Some last-minute bargaining over the precise allotments for defense and foreign aid (see Table 6) reflected concerns of Japan's top policymakers over international events, such as the dire economic needs of Eastern Europe, the Soviet Union, China and the developing countries; the end of the Cold War; the threat of hostilities in the Persian Gulf; a possible disruption of oil supplies; slower U.S. economic growth; and troubled multilateral trade talks. Concerns about the health of Japanese financial institutions (due to the sliding prices of domestic stocks and potentially unstable real estate markets), worries about inflation at home and the likelihood of an economic slowdown further complicated the budget process. Although the government acted swiftly to draft a FY 1991 budget, prospects for quick passage through the Diet are doubtful. Opposition parties are in control of the upper house and are examining carefully the government's defense and tax proposals. A pitched battle on these and other issues is a strong possibility.

Jon Choy

Tokyo Slows Defense Buildup Amid Global Changes

As anticipated, the cabinet of Prime Minister Toshiki Kaifu approved on December 20 a Y22.8 trillion ($168.9 billion at Y135=$1.00) five-year defense program ostensibly designed to satisfy Japan's security requirements in the post-Cold War era. The FY 1991-FY 1995 Medium-Term Defense Plan, which will go into effect April 1, generally will hold annual spending increases to 3 percent before adjustment for inflation, well below the 5.4 percent average yearly hike the Japan Defense Agency enjoyed during the FY 1986-FY 1990 plan. Although the budget for new weapons systems will decrease by an estimated 2.3 percent a year over the next five years, the overall plan allows for continued qualitative improvements, particularly in the areas of increased host-nation support and improved living and working conditions for Self-Defense Forces personnel (see Table 1). After three years the new plan may be subjected to a review to allow for adjustments in spending, equipment procurement and personnel in accordance with changes in the global security environment.

Table 1: FY 1991-FY 1995 Defense Program

Category	Amount (trillions of yen)	Percentage Distribution	Annual Growth (in percent)
Total Spending	Y22.75	100.0%	3.0%
Personnel Costs	8.50	37.4	0.6
Equipment Purchases	5.10	22.4	2.1
(purchases on contract basis)	(5.0)	---	(-2.3)
Rear Support	9.15	40.2	5.9

Source: Japan Defense Agency

Mr. Kaifu described the defense program as "very restrained." The scaled-back FY 1991-FY 1995 plan means that JDA will not get all that it had hoped for in the weapons area. Items the defense agency was able to secure from its "wish list" include 36 vehicle-mounted multiple-launch rocket systems, four AWACS (airborne warning and control system) and two Aegis destroyers (see Table 2). As a result of these planned big-ticket purchases, the pace of tank and

Table 2: Major Equipment Purchases, FY 1991-FY 1995

Item	Quantity to be Procured
Ground Self-Defense Force	
Tanks	132
Artillery Pieces	716
Multiple-Launch Rocket Systems	36
Armored Personnel Carriers	218
Ground-Based Antiship Missiles	40
Antitank Helicopters (AH-1S)	20
Transport Helicopters (CH-47J)	14
Surface-to-Air Guided Missiles (improved HAWK)	2.5*
Maritime Self-Defense Force	
Destroyers	10
Submarines	5
Auxiliary Ships	20
Antisubmarine Patrol Aircraft (P-3C)	8
Antisubmarine Helicopters (SH-60J)	36
Minesweeping Helicopters (MH-53E)	1
Air Self-Defense Force	
Fighter Aircraft (F-15)	42
Transport Aircraft (C-130H)	3
Transport Helicopters (CH-47J)	2
AWACS	4
Intermediate Training Aircraft (T-4)	90
Surface-to-Air Guided Missiles (Patriot)	1*

*Missile groups

Source: Japan Defense Agency

destroyer purchases will slow. That prospect, combined with a relatively faster timetable for scrapping obsolete equipment, means the total number of tanks owned by the Ground Self-Defense Force will decrease by FY 1996 from the current 1,205 to 1,134, while the number of Maritime Self-Defense Force destroyers will drop from 62 to 58.

JDA officials emphasize, however, that actual combat capabilities will remain at about the same level because the advanced Type-90 tank and the Aegis destroyer will more than compensate for the retirement of their predecessors. This reassurance no doubt was aimed at the Pentagon, which since the early 1980s has urged Japan to acquire not only additional but more sophisticated equipment to better realize its commitment to defend the area 1,000 nautical miles east and south of the home islands. Japanese defense planners also pointedly note for the benefit of American observers that the planned AWACS and Aegis procurements are in response to Washington's request that Tokyo purchase more systems off-the-shelf from U.S. defense contractors.

Although JDA originally wanted the new defense program to include authorization for tanker-refueling aircraft and over-the-horizon radar, projected economic constraints as well as domestic and regional concerns that the high-priced items would endow Japan with too much of a power projection capability persuaded officials to delist them. The defense agency will continue feasibility studies of these two hardware items during the next five years with an eye toward possible future deployment.

The FY 1991-FY 1995 plan also does not include money to purchase the FSX fighter support aircraft. This, however, should not affect the joint development effort between Mitsubishi Heavy Industries, Ltd. and General Dynamics Corp. since design and development problems have pushed the plane's delivery date well into the late 1990s.

While reining in spending on weapons systems, the plan seeks to improve the standard of living for SDF members, primarily as a way to improve recruitment. The Y8.5 trillion ($63 billion) earmarked for personnel-related expenses will go toward upgrading living and working quarters and recreational facilities. Responding to American requests for greater sharing of the mutual defense burden, Japanese defense planners also reordered the slimmed-down budget to enable Tokyo to cover approximately 50 percent of the roughly $6 billion annual cost of maintaining U.S. forces in Japan, a 10 percentage point increase (see JEI Report No. 48B, December 21, 1990).

In greeting Tokyo's defense program for the next five years the Department of Defense stated December 20 that the Japanese government's decision to increase host-nation support, in particular, was "very much welcomed and appreciated." Commenting on the 3 percent projected average annual increase in defense spending, the Pentagon pointed out that, in contrast, "other countries' defense budgets are decreasing."

Congress may not react as favorably to Japan's scaled-back program. Before the 101st Congress adjourned in October 1990, legislators passed a nonbinding resolution that called on Japan to assume 100 percent of the yen costs associated with stationing U.S. troops there. Tokyo's failure to do so, the resolution stated, would precipitate a "rapid" withdrawal of American forces from Japan. Congress may not be appeased by Tokyo's plan to shoulder about 50 percent of the overall expenses, particularly if war breaks out in the Persian Gulf and the Japanese government caps its allied contribution at a strictly financial level, namely the $4 billion already pledged.

Judging by the government's action on the FY 1991 defense budget, JDA appears to be off to a good start in implementing its new five-year plan. The cabinet December 29 approved Y4.4 trillion ($32.5 billion) for defense spending in the year beginning April 1, up 5.5 percent from the current fiscal year's initial budget. Adopting its characteristic tight-fisted approach to budget talks, the Ministry of Finance initially proposed a 5.1 percent rise; JDA was able to realize the higher increase through dogged bargaining.

The 5.5 percent increase, which exceeds the 3 percent average annual growth envisioned in the five-year plan, is needed to cover higher personnel-related costs and payment of earlier hardware contracts, according to JDA explanations. The FY 1991 budget will enable JDA to contract for a third Aegis destroyer for the MSDF fleet, one conventional destroyer, two F-15 fighter aircraft, two T-4 trainer aircraft and 28 Type-90 tanks on top of the purchasing list approved earlier. Some reports indicate that what may have clinched the higher spending increase for the defense agency was JDA director general Yozo Ishikawa's strong argument for money to improve living standards for SDF members.

Barbara Wanner

Japan Outlines Gulf Support; More Aid For Region Anticipated

Criticism of Tokyo's contribution to peacekeeping efforts in the Middle East flared again in mid-December as the Pentagon announced that only about half of the $8 billion pledged by Japan and other U.S. allies had been delivered. The announcement spurred legislators to examine the costs of Operation Desert Shield and allied contributions to the peacekeeping effort both independently and in a January 4 briefing for the House Budget Committee. Meanwhile, Japan's cabinet submitted to the Diet a FY 1991 foreign aid budget that is 8 percent higher than the initial FY 1990 figure, an increase due in part to the anticipated need to provide more aid to countries adversely affected by the Middle East crisis.

Last September Tokyo pledged $2 billion for logistical support of the multinational peacekeeping effort in the Persian Gulf and $2 billion for economic aid to frontline countries (see JEI Report No. 36B, September 21, 1990). In response to Washington's claims that Tokyo's contributions were coming up short of this amount Foreign Ministry officials provided figures in mid-December showing that while disbursements toward the peacekeeping effort have not yet reached the total pledged last September, assistance directed to American forces in the Persian Gulf exceeded Pentagon-generated estimates of roughly $476 million in cash and in-kind support.

Japanese officials reported that as of mid-December about $600 million had been spent or contracted for logistical support, including: roughly $100 million of in-kind aid, such as vehicles, office and desalination equipment, and construction materials; approximately $430 million paid to the Department of the Treasury for troop transportation costs; and $70 million for transportation cooperation, specifically for chartering cargo-carrying ships and aircraft. Of the $2 billion pledged in assistance to frontline countries $950 million had been allocated or disbursed, the Foreign Ministry said. This included $600 million in emergency commodity loans. Of that amount $200 million had gone to Turkey and $100 million was being disbursed to Jordan; an exchange of notes was being finalized that would provide $300 million to Egypt.

The Foreign Ministry reported that the additional $350 million in assistance to the frontline countries included: $150 million for an "Industry and Trade Policy Adjustment Loan" to Jordan; $100 million to Egypt for a cement factory and $100 million to Turkey for the expansion of a bridge. Japanese officials also outlined Tokyo's evacuee relief efforts, of which $22 million was shared by the International Committee of the Red Cross, the United Nations Disaster Relief Coordinator's Office, and the International Organization for Migration. In addition, $900,000 was provided to Jordan for relief materials, while Japanese flights carried about 800 evacuees out of the region.

Japan's deputy chief of mission in Washington, Takayuki Kimura, linked delays in contributions backstopping the allied peacekeeping effort to the

Pentagon's slowness in producing lists of needed equipment and to the time span involved in procuring equipment. He noted that approximately $400 million soon would be spent on additional nonmilitary gear for the multinational forces in the Middle East, press reports said. Moreover, Mr. Kimura added that the roughly $1 billion remaining of the $2 billion pledge was included in the supplemental budget for FY 1990, approved by the Diet in mid-December (see JEI Report No. 48B, December 21, 1990).

The Foreign Ministry's explanations may do little to ease resentment in Washington regarding Japan's help in defraying the enormous cost of the U.S. military mission in the Middle East. Delays in disbursement and the absence of Japanese personnel in the Persian Gulf continue to be sore points on Capitol Hill and in the media. Additional criticism has focused on the fact that Japan's aid to frontline states is in the form of loans rather than grants and that some of the loans are designated for specific projects.

Some in Congress and the press have accused the Bush administration of not demanding enough of U.S. allies. House Majority Leader Richard Gephardt (D, Mo.) and Rep. Charles Schumer (D, N.Y.) in mid-December warned that Congress would look askance at authorizing further funds for Operation Desert Shield without additional commitments from American allies. Administration officials have indicated that they have made their expectations of further assistance clear to U.S. allies in ongoing talks. Although the White House reportedly has not requested additional support from Japan in its upcoming fiscal year, Foreign Minister Taro Nakayama recently indicated that Tokyo would consider providing further funds for the gulf operation. The foreign minister is scheduled to discuss the Middle East crisis with Secretary of State James Baker during his January 13-17 visit to the United States.

Several Washington observers suggest that the White House wants to secure additional financial support from U.S. allies before congressional battles begin over the cost of Operation Desert Shield. Administration officials canceled scheduled testimony for a January 4 House Budget Committee briefing called to examine costs and allied contributions to the U.S.-led multinational forces in the Persian Gulf. Although the General Accounting Office told the House panel that even without hostilities the cost of the mission would exceed $30 billion in the current fiscal year, uncertainties abound over how much Operation Desert Shield will cost.

Meanwhile, Tokyo has earmarked a significant increase in its official development assistance budget for FY 1991. In recent years Japan has sought to supplement its defense spending and contribute toward burdensharing through its foreign aid program. In 1988 the government announced a fourth medium-term foreign aid plan, which set out to increase ODA commitments to $50 billion between 1988 and 1992 (see JEI Report No. 47A, December 14, 1990). The initial FY 1991 budget for ODA is set at Y883.1 billion ($6.5 billion at Y135=$1.00), an 8 percent increase from the comparable FY 1990 number.

The Foreign Ministry was able to wrest the 8 percent increase after a struggle with the Ministry of Finance, which argued that a lower rate of growth would be sufficient to meet the five-year foreign aid target. The Foreign Ministry originally proposed a 10.1 percent budget hike in contrast to the 5.8 percent rise recommended at one point by the Finance Ministry. The expected needs of countries adversely affected by the Middle East crisis buttressed the

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REPORT

A Two-Part Report: A and B

NO. 2B
January 18, 1991

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Yen Rides Roller Coaster In 1990

For the yen 1990 represented disaster avoided. During 1989 the Japanese currency had showed unexpected weakness. Its slide continued into the first few months of 1990. During a few grim days in early April some observers felt that Japanese financial markets threatened to reel out of control. The stock market plunged, interest rates soared and the yen plummeted to as low as Y159.8=$1.00, a level not seen in three years. But even in the midst of this apparent crisis Japanese economists pointed out that the economy still was strong and that labor markets, if anything, were too tight. They suggested that financial markets had overreacted to a relatively small change in Bank of Japan monetary policy that had led to higher interest rates. This view implied that key financial indicators soon could reverse themselves.

By year's end these economists had been proven at least one-third correct. Although interest rates showed a mixed pattern at best and the stock market sank further during the second half of the year, the Japanese currency righted itself and then some. As a result, it finished 1990 stronger than it was December 31, 1989 -- although the turbulence earlier in the year and renewed weakness at yearend were enough to keep the yen's 1990 average value below that of 1989's (see Table 1). And despite the currency's broad swing during 1990, the recent pattern of diminishing year-to-year variation continued; the 4.7 percent depreciation of the yen between 1989 and 1990 was the smallest percentage move in either direction since 1985.

Table 1: Yen-Dollar Exchange Rate, 1985-90

(monthly average, Tokyo interbank market)

	1985	1986	1987	1988	1989	1990
January	Y254.1	Y200.0	Y154.5	Y127.6	Y127.2	Y145.1
February	260.3	184.6	153.5	129.2	127.8	145.5
March	258.4	178.8	151.5	127.3	130.4	153.1
April	251.7	175.6	143.0	125.0	132.1	158.5
May	251.6	166.9	140.5	124.8	138.4	153.5
June	249.0	167.8	144.5	127.1	143.8	153.8
July	241.7	158.7	150.2	133.1	140.7	149.3
August	237.2	154.1	147.6	133.6	141.1	147.4
September	236.9	154.8	143.0	134.4	145.1	139.0
October	214.8	156.0	143.5	129.0	141.9	129.7
November	203.9	162.7	135.3	123.2	143.5	129.1
December	202.8	162.1	128.4	123.6	143.6	133.7
Annual Average	238.5	168.5	144.6	128.2	138.0	144.8

The Japanese currency's low in April culminated a decline that in retrospect appears to have begun in November 1988. For 1991 the obvious question is whether the yen's newfound strength will be as durable as was its weakness, which lasted 17 months. American analysts are sharply divided on this point. Of 40 economists surveyed by the Wall Street Journal in early January on the value of the yen at the end of 1991, 19 expected the yen to appreciate compared to its 1990 closing value, while 21 said it would decline; the average forecast of Y138=$1.00 was very close to the December 31 figure of Y135.8. No one expected the yen to break through the Y120 barrier for a sustained period, even though it has approached that level three times since 1987. Given the distinct possibility that another long yen swing may have begun in May, this outcome should not be discounted.

Japanese experts appear to be somewhat more optimistic about the yen. An early January survey by Nihon Keizai Shimbun, widely regarded as the Journal's Japanese counterpart, asked slightly different questions than in the U.S. survey, but the responses implied an average forecast of Y134.1=$1.00 (obtained by calculating the midpoints of the expected range of values over 1991). Of the 47 forecasters queried, 19 expected the Japanese currency to cross the Y120 threshold at some point during 1991.

A look at what the Japanese currency did against currencies other than the dollar last year (see Table 2) gives credence to the case for a strong yen. In 1990 the yen continued to sink against European currencies, which increasingly are linked to each other. The yen's yearend value against the Deutsche mark was the lowest since 1982. Economic fundamentals would appear to warrant

Table 2: Changes in the Yen Against Selected Currencies, 1989-90

(other currencies in terms of yen at yearend)

	1989	1990	Percent Change
German Deutsche mark	Y85.18	Y90.84	-6.2%
British pound	232.30	262.09	-11.4
Canadian dollar	124.27	117.07	6.2
Australian dollar	113.68	104.91	8.4
Korean won	0.21	0.19	11.8
Singapore dollar	75.74	78.25	-3.2
Taiwan dollar	5.52	5.10	8.3
Hong Kong dollar	18.44	17.41	5.9
U.S. dollar	143.91	135.80	6.0

much greater strength against European currencies. Thus, absent a strengthening of the dollar against the Deutsche mark, the yen should appreciate against both the dollar and European currencies.

The table also indicates how the yen performed on a year-to-year basis against some of its important Asian counterparts. Except for the Singapore dollar, the yen rose a comparable amount against the dollar and the Asian currencies listed. As such, the pattern was similar to, but the reverse of, 1989's. That year the yen dropped against all the indicated Asian currencies as well as the dollar. This outcome suggests that, through market forces or government action, Asian exchange rates remain more closely linked to the American currency than to the Japanese one. It also implies that Asian currencies are likely to depreciate against the yen should the yen strengthen against the American dollar.

Currency traders, of course, play political and economic prophet in taking exchange rate positions; as such, current exchange rates reflect a consensus among traders as to future developments. Currency forecasters make similar judgments; for this reason projected exchange rates are likely to approximate current levels. Neither traders nor forecasters can claim unusual clairvoyance, however, and the current economic and political environment has created unusually cloudy crystal balls.

For example, an American recession more severe than now predicted would raise the demand for foreign capital to finance a federal budget deficit that would grow beyond expected levels; that would boost the dollar. Just the reverse also is possible; if the recession turns out to be short, capital demands could be modest, lowering the value of the dollar below analysts' current best guesses. A prolonged Middle East conflict by itself probably would lift the dollar by increasing the demand for borrowed funds to wage war, but inflationary forces unleashed by a combination of higher oil prices and inappropriate monetary responses to changing fiscal conditions could weaken the American currency. For these reasons few people should be surprised to see big swings in the yen-dollar exchange rate during 1991 as traders weigh the likelihood of these contradictory scenarios.

Douglas Ostrom

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REPORT

A Two-Part Report: A and B

NO. 3A January 25, 1991

PATTERNS AND IMPLICATIONS OF JAPANESE STOCKHOLDING

Summary

Japan's increased importance in the global economy has focused attention on a normally unremarkable subject: the pattern of stock ownership in Japan. A broad range of phenomena are different facets of this one subject -- the willingness of corporate management to accept low profits and their freedom to engage in long-range strategic planning; the role of keiretsu or industrial groups in the economy and their impact on market liberalization; barriers to mergers and acquisitions of Japanese companies; shareholders' rights; and the behavior of the Japanese stock market. Trends in patterns of Japanese stock ownership, the reasons behind these developments and their implications will be examined in this report. A review of private and government reactions to current stockholder patterns and a look at factors that may influence them in the future round out the analysis.

Alike . . .

As in other areas, much of the structure of the American stock market was transplanted to Japan during the U.S. occupation after World War II. Companies issue shares that are bought and sold by investors through securities brokers interacting in an institutionalized marketplace. The price of a share on the Tokyo Stock Exchange is determined through a pure, order-driven auction system of matching buy and sell orders. (The Tokyo Stock Exchange is used here as a proxy for all stock trading in Japan since it accounts for about 85 percent of the total volume and value of that country's stock exchange activity. There are small differences in rules and procedures between the TSE and Japan's other stock exchanges as well as with its rapidly growing over-the-counter market, but they are immaterial to the points raised in this report.)

Investors range from individuals to giant financial and nonfinancial institutions, but the system has two important quirks. Unlike banks in the United States, banks in Japan are allowed to hold up to 5 percent of the shares of a nonfinancial corporation. As will be detailed below, banks control a major portion of the total shares outstanding; consequently, their trading activity is a key factor in the market. Again, unlike the U.S. situation, a holding-company structure is illegal under Japan's Antimonopoly Law. This feature, in particular, has left a deep impression on the pattern of Japanese stockholding.

Table 1 presents a historical view of Japanese share ownership by type of investor. It clearly reveals several trends. (Data from the early 1950s must be considered atypical as stock markets were being restarted after the war.) Financial institutions (excluding securities firms) showed the sharpest increase in ownership, with their share of all stock outstanding nearly tripling between 1955 and 1989. Over the same period the nonfinancial corporate sector almost doubled its share of the pie. Together, the two groups expanded their stockholdings from about 30 percent of all shares outstanding in 1955 to nearly 71 percent of the total in 1989. The role of foreign investors underwent sporadic growth spurts, remaining below 2 percent through 1968, reaching a second plateau of 3 percent-plus in the first half of the 1970s, and then fluctuating generally between 4 and 6 percent in the 1980s. These gains clearly came at the expense of individuals; their share fell by more than half after 1955. This shift in the balance of assets between individuals and the business sector is supported by data on a national accounts basis (see Table 2).

It must be underlined that the absolute value of securities owned by all groups has grown tremendously since the 1950s, with much of this growth occurring in the late 1980s; the share held by small investors showed a relative decline only because the business sector added to its portfolio much more rapidly. This shift in share balances is logical in light of Japan's postwar economic history. The rapid growth of Japanese industry and the relatively weak position of consumers versus producers in Japan explain the relative drop in stock ownership by individual investors.

The Japanese case is not unique, however. Stock ownership has shown a similar shift in the United States. According to information from the Federal Reserve Board, institutional stockholdings grew from 16 percent of the total in 1965 to 44 percent in 1989. The share held by individuals fell over the same period from 84 percent to 56 percent. The shift was even more pronounced since the small investor share includes portfolios controlled by trusts and nonprofit organizations, which account for between 25 percent and 30 percent of the total. Flow of funds data indicate that while the share of all U.S. financial assets held by individuals declined moderately between 1970 and 1988 (from 53.6 percent to 43.8 percent), households put considerably less of their total assets into stocks over this period (27.5 percent in 1970 versus 15 percent in 1988). Private estimates of the breakdown of small investors' portfolios reveal a similarly reduced role for stocks -- from as much as 50 percent of total portfolio value in 1970 to less than 30 percent in 1990.

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Table 1: Share Ownership by Type of Investor, All Listed TSE Companies

Year	Public Sector	Financial Companies	Investment Trusts	Securities Companies	Nonfinancial Firms	Individuals	Foreigners
1951	3.1%	12.6%	0.0%	11.9%	11.0%	61.3%	0.0%
1952	1.8	13.0	5.2	9.2	13.8	57.0	0.0
1953	1.0	15.8	6.0	8.4	11.8	55.8	1.2
1954	0.7	16.3	6.7	7.3	13.5	53.9	1.7
1955	0.5	16.7	7.0	7.1	13.0	54.0	1.7
1956	0.4	19.5	4.1	7.9	13.2	53.1	1.8
1957	0.3	21.7	3.9	7.1	15.7	49.9	1.5
1958	0.2	21.4	4.7	5.7	16.3	50.1	1.5
1959	0.3	22.4	6.6	4.4	15.8	49.1	1.5
1960	0.2	21.7	7.6	3.7	17.5	47.8	1.5
1961	0.2	23.1	7.5	3.7	17.8	46.3	1.4
1962	0.2	21.4	8.6	2.8	18.7	46.7	1.7
1963	0.2	21.5	9.2	2.5	17.7	47.1	1.8
1964	0.2	21.4	9.5	2.2	17.9	46.7	2.1
1965	0.2	21.6	7.9	4.4	18.4	45.6	1.9
1966	0.2	23.4	5.6	5.8	18.4	44.8	1.8
1967	0.2	26.1	3.7	5.4	18.6	44.1	1.9
1968	0.3	28.2	2.4	4.4	20.5	42.3	1.9
1969	0.3	30.3	1.7	2.1	21.4	41.9	2.3
1970	0.3	30.7	1.2	1.4	22.0	41.1	3.3
1971	0.3	30.9	1.4	1.2	23.1	39.9	3.2
1972	0.2	32.6	1.3	1.5	23.6	37.2	3.6
1973	0.2	33.8	1.3	1.8	26.6	32.7	3.5
1974	0.2	33.9	1.2	1.5	27.5	32.7	2.9
1975	0.2	33.9	1.5	1.3	27.1	33.4	2.5
1976	0.2	34.5	1.6	1.4	26.3	33.5	2.6
1977	0.2	35.1	1.4	1.4	26.5	32.9	2.6
1978	0.2	35.9	2.0	1.5	26.2	32.0	2.3
1979	0.2	36.6	2.2	1.8	26.3	30.8	2.1
1980	0.2	36.9	1.9	2.0	26.1	30.4	2.5
1981	0.2	37.3	1.5	1.7	26.0	29.2	4.0
1982	0.2	37.3	1.3	1.7	26.3	28.4	4.6
1983	0.2	37.7	1.2	1.8	26.0	28.0	5.1
1984	0.2	38.0	1.0	1.9	25.9	26.8	6.3
1985	0.2	38.5	1.1	1.9	25.9	26.3	6.1
1986**	0.8	42.2	1.3	2.0	24.1	25.2	5.7
1987	0.9	43.5	1.8	2.5	24.5	23.9	4.7
1988	0.8	44.6	2.4	2.5	24.9	23.6	3.6
1989	0.7	45.6	3.1	2.5	24.9	22.4	4.0

*Beginning in 1986 figures based on number of 1,000-share "unit" shareholders.

Source: Ministry of Finance and the National Conference of Stock Exchanges, as cited in Tokyo Stock Exchange 1990 Fact Book.

Table 2: Stock Ownership by Institutional Sector

(share of all stock assets; closing balance; national accounts basis)

Year	Nonfinancial Enterprises	Financial Institutions	Government	Households*
1970	33.7%	26.1%	0.0%	40.1%
1975	33.4	30.7	0.0	35.8
1980	37.7	29.5	0.0	32.8
1981	36.9	31.3	0.0	31.8
1982	34.7	34.2	0.0	31.0
1983	36.4	34.0	0.0	29.5
1984	37.1	34.9	0.0	27.9
1985	36.5	36.0	0.3	27.2
1986	37.6	36.5	0.2	25.6
1987	38.3	35.4	0.1	26.2
1988	37.5	36.5	0.1	25.9

*Includes private, unincorporated nonfinancial enterprises.

Source: Economic Planning Agency, Annual Report on National Accounts, 1990.

In both Japan and the United States, however, the number of people owning stock has grown sharply if erratically. Between 1950 and 1965 the number of share owners in Japan more than tripled from less than 5 million to 17 million-plus. After marking time for a decade, the figure plateaued again between 1975 and 1980 at about 19 million. Following a downturn in the mid-1980s, the number of individual shareholders hit a new high of 21.6 million at the end of 1989. Share owners as a percentage of the total population traced a similar path in both Japan and the United States: rapid growth before 1970 to the mid- to upper teens; a slight decline between 1970 and 1980; and then a spurt to almost 20 percent by the late 1980s.

The role of individual Japanese investors in market activity belies their relatively limited holdings. The number of trades initiated by individuals has ranked first or second since at least 1985 (see Table 3). But the impact of the sharp shift in the balance of share ownership between individuals and corporations also is visible from this perspective. Activity by banks and nonfinancial corporations has risen proportionately, while the share attributable to individuals has fallen by about one-third.

. . . Yet Different

While the structure and the history of Japanese shareholding patterns may be similar to those in the United States, the behavior of Japanese investors, particularly the corporate sector, differs in important respects. Similarly, the Japanese stock market may be structured almost identically to its U.S. counterpart, but it still has a unique character.

Table 3: Stock Transactions by Investment Sectors*

(percentage of the total value of transactions)

	1985	1986	1987	1988	1989
Members	24.2%	26.3%	25.2%	26.5%	23.3%
Individuals	36.9	29.2	26.0	23.7	23.3
Foreigners	12.5	10.9	10.0	7.4	8.7
Insurance Companies	0.9	1.0	1.0	1.1	1.0
Banks	8.1	12.7	16.8	18.9	20.2
Investment Trusts	4.3	4.7	5.1	5.9	7.9
Nonfinancial Firms	8.7	10.9	11.5	12.4	11.4
Others	4.4	4.4	4.3	4.1	4.2

*Figures based on trading on the first and second sections of the Tokyo, Osaka and Nagoya stock exchanges.

Source: Tokyo Stock Exchange Fact Book, 1990.

Keiretsu or Industrial Groups - Both Japanese and American historians cite the dissolution of tightly linked, vertically integrated industrial combines or *zaibatsu* as a key achievement of the U.S. occupation's program to recast Japan as a liberal democracy. To prevent such tightly knit (and, therefore, easily controlled) behemoths from reappearing, Japan's Antimonopoly Law prohibits the holding-company structure that was the *zaibatsu*'s strength. Despite numerous revisions of the antitrust law, the holding-company ban remains absolute. Nevertheless, major Japanese banks and manufacturers, aware that increased corporate influence often translates into greater commercial strength, quickly organized industrial groups or *keiretsu* that provided many of the economic advantages of *zaibatsu* with less formal links. (For a full analysis of *keiretsu*, see JEI Report No. 2A, January 12, 1990.)

Besides interlocking boards of directors, personnel exchanges and informal group associations, *keiretsu* members are linked through ownership of each other's shares. For the largest *keiretsu* the average percentage of a member firm's stock held by other group members has increased over the past 25 years, ranging from 7 to 14.3 percent in 1963 compared to 12.2 to 26.9 percent in fiscal 1988. The ratio can be even higher for some manufacturing *keiretsu*. Hitachi, Ltd., the core company of the 688-firm Hitachi Group, has an informal policy of holding at least 50 percent of the shares of every group member, according to press reports. Since the number of group-owned shares is kept relatively constant, a significant portion of both outstanding shares and new stock issued by group members is removed from the market.

Cross-Stockholding - A less extreme but more widespread phenomenon is the traditional practice among business partners of holding a small amount of each other's stock as a token of commitment and trust. While the amount involved in each transaction may be tiny, the cumulative total can be consequential since each company does business with many partners. Selling these goodwill tokens occurs only when the business relationship breaks down. A one-sided version of cross-stockholding also exists. The impact on the amount of stock available for trading is similar to that of intragroup holdings.

Stable Shareholders - Institutional investors -- trust funds, pension funds and insurance companies -- have built up huge stock portfolios as a natural consequence of their fiduciary operations. The investment strategy of these giant investors is conservative almost to a fault since they are likely to hold shares of Japanese stocks for years, patiently waiting for capital gains. (Their foreign investment strategy often differs sharply, however, as they try to take advantage of the much higher dividends offered by foreign equities.) Even when institutional investors sell shares to realize capital gains, they often will buy back the stock immediately to maintain the desired portfolio composition.

A second type of stable shareholding is an extreme, often one-sided, version of cross-stockholding. In order to win the business of a customer Japanese companies (usually insurers and banks) will take a significant stake in the firm. Companies in need of capital often will propose this type of arrangement to institutional investors. Similarly, businesses faced with hostile overtures frequently employ this tactic as a defensive measure. Thus, Japanese firms actively seek stable shareholders for two reasons: they form a bulwark against hostile takeovers and they usually, but not always, support the policies of existing management.

Zaiteku or Financial Management - Until the mid-1980s Japanese manufacturers and other nonfinancial companies did not consider active management of their financial resources a priority business undertaking. The appreciation of the yen against most major foreign currencies (which hurt the profitability of exporters and related firms) and the country's skyrocketing stock and real estate markets worked like stick and carrot, respectively, to change this attitude. For many companies quick and sizable profits from stock and land speculation masked losses from basic operations. This attitudinal shift is a major factor behind the upsurge in corporate stock trading in the past several years.

Big Four Securities Firms - Unlike in the United States, four Japanese brokerage houses -- Nomura Securities Co., Ltd., Daiwa Securities Co., Ltd., Yamaichi Securities Co., Ltd. and Nikko Securities Co., Ltd. -- control a dominant share of trading on Japan's stock and bond markets. Until 1989 they directly accounted for about 40 percent of all Tokyo Stock Exchange volume, a figure that rises to 60 percent or more if trading by smaller affiliates is counted.

Such a concentration of market power can distort trading patterns. Buy and sell recommendations, for example, often were based on which stocks the Big Four were promoting at any instant rather than the economic fundamentals of the favored companies. TSE trading was characterized by "themes" -- furious activity focusing on groups of companies selected by the Big Four for some (not always realistic) reason -- that lasted no more than a few days and often as little as a few hours. While 1988 Ministry of Finance guidelines limiting brokerage activity (see below) have reduced the influence of the Big Four in the spot market for stocks, observers complain that the oligopoly has evaded this guidance at the margins by dominating activity in new markets, such as stock and bond futures. This dominance corrupts the invisible hand of supply and demand in Japanese equity markets and puts investors on unequal footings.

Why It Matters

The effects of this pattern of stockholding are surprisingly profound. Certain consequences long have been the target of foreign criticism, especially by the United States. Other results, however, recently have become subjects of domestic debate.

- Stock Trading Effects - The basic feature from which all else derives is the severely limited amount of stock available for active trading due to cross- and stable shareholding. According to Japanese and foreign estimates, cross- and stable stockholdings account for between 60 and 70 percent of the outstanding shares on the TSE. (New equity flotations do not change the situation since cross- and stable shareholders are expected to maintain their previous ownership ratios.)

While on paper the TSE's 300 billion-plus shares outstanding appear to make it a highly liquid market, its true liquidity is far less because of cross- and stable stockholding. Combined with the market influence of the Big Four securities firms, the TSE not surprisingly has developed a reputation for being a manipulated market. The Big Four and large investors can sway the price of a particular stock or even the entire market. Such influence is not unlimited (the TSE's drastic decline in 1990 makes this clear), but it cannot be ignored.

Small investors particularly are hurt by these and other market distortions. Inside information in Japan includes not only the sort of key corporate data that fall under the U.S. definition but also the tips and the rumors on which shares become a target of interest by the Big Four and other traders. Since individual or small investors rarely are privy to such information, they do not benefit along with in-the-know investors from the market's swings. The TSE's reputation for manipulation, coupled with recent scandals involving brokers compensating major clients for trading losses (see JEI Report No. 40B, October 19, 1990), has caused small investors to question the wisdom of putting their money into equities.

Cross- and stable stockholding also can amplify market swings. When the market is rising, for example, companies issue new shares. Stable shareholders are obligated to buy a major portion of these shares; that boosts the market and completes the virtuous circle. According to Japanese stock analysts, a significant percentage of the funds raised during the TSE bull run flowed back into the market because of cross-shareholding policies. Japan's ownership pattern becomes a vicious circle when the market is dropping, as was demonstrated in 1990. Falling stock prices shrank the value of corporate investment portfolios, worsening business results and depressing prices further. Since the web of cross-stockholding is so extensive, significant price movements in enough stocks can pull the entire market in the same direction.

The shrinking share of stocks owned by individuals is a growing concern to stock market watchers. Because institutional and corporate investors can issue trading orders involving their entire portfolios in seconds thanks to computerized trading and these orders usually involve millions of shares, stock market administrators worry that the market will become excessively volatile as the role of big investors grows. Small investors tend to ride out market vagaries, and they often are the most active bargain hunters when the market is down. Both tendencies help to stabilize swings in share prices. As mentioned above, individual investors still account for a major portion of trading activity, but their role is declining relative to trading by financial firms and other members of the business community.

- Independence of Corporate Management - Analyses of the competitive strengths of Japanese corporations often cite management's willingness to accept low profits for many years, industry's long-range outlook and steady, persistent corporate effort as critical components of their commercial success. While other factors are involved, a major reason management can adopt policies like these is the support top executives derive from cross- and stable shareholders. As long as management can count on the support of two-thirds of the stockholders, any effort to influence company policies can be defeated, whether it comes from a stockholder or an outsider. Management also can force through such unpopular policies as low dividend payouts and low per-share dividends with the backing of cross- and stable shareholders.

While American and European companies devote half or more of their profits to dividends, the average for Japanese firms listed on the TSE was only 27.6 percent in 1989. Most publicly traded firms set their dividends based on a share par value of Y50 ($0.37 at Y135=$1.00); nearly 60 percent of the TSE-listed companies have dividends of just Y5 to Y7 ($0.04 to $0.05) per share. Furthermore, dividend rates rarely are altered, even when a firm enjoys excellent profits. Combined with relatively high share prices, TSE stocks have astronomical price/earnings ratios (60 at the market's 1989 peak and still in the high 40s compared with an average in the 20s for shares listed on the New York Stock Exchange) and miniscule yields (an average of less than 0.5 percent versus more than 3 percent in the United States).

Even when a company is experiencing difficulties, cross- and stable shareholders are more likely to offer assistance to current management than call for its ouster. Dissatisfaction must reach extremes before cross- and stable shareholders balk.

- Shareholders' Rights - The converse of management independence is limited shareholders' rights. In Japan's hierarchical society management's position is superior to that of stock owners; the former have the power to make all decisions and the latter are relegated to accepting these decisions and remaining silent. An indication of the passive role share owners are expected to take is that the majority of Japanese firms not only hold their annual stockholders' meetings on the same day and at practically the same time but they informally compete to see which firm has the shortest meeting. (More than 1,600 publicly listed firms held their annual meetings on the same day last year, with the average gathering lasting less than 30 minutes.)

Japan's commercial code clearly defines the rights of shareholders with regard to management. If a shareholder owns the following amount of a company's outstanding stock for at least six months, he or she can:

-- 1 percent - Make proposals at the shareholders' meeting; vote in that meeting; and inspect the register of shareholders.
-- 3 percent - Convene a shareholders' meeting.
-- 10 percent - Inspect and make copies of accounts and other company records.
-- 33.4 percent - Veto decisions that require a two-thirds majority.
-- 50 percent - Appoint director(s).
-- 66.7 percent - Remove director(s); change the articles of incorporation; and approve mergers and the transfer of substantial assets.

Backed by cross- and stable shareholders management often can brush aside any proposals made by small investors as well as their objections. In addition, Japanese organized crime has extended a tentacle into the picture. *Sokaiya* or "professional shareholders" buy a 1 percent stake in a company either to: harass and disrupt the annual meeting (they then extort money from management in exchange for a promise not to do it again); or verbally and/or physically suppress shareholders that may be troublesome to management (also extorting money from management for this service). Last year, for example, *sokaiya* disrupted more than a dozen annual meetings, while others gave the bum's rush to shareholders who tried to question management policies, such as antinuclear protesters and T. Boone Pickens, the American corporate raider. Although Mr. Pickens is not a popular figure in Japan, his cause has attracted attention and spurred debate.

Via his Texas investment bank, Boone Co., Mr. Pickens bought 20.2 percent of a publicly traded Japanese automotive parts maker, Koito Manufacturing Co., Ltd., in April 1989. The purchase made Mr. Pickens Koito's largest single shareholder, followed by Toyota Motor Corp. with its 19 percent stake. Disregarding Mr. Pickens' professed desire to expand Koito's sales and his requests for representation on the company's board of directors, management has held Mr. Pickens at arm's length with the backing of the firm's friendly shareholders led by Toyota. Although Mr. Pickens has increased his Koito stake to 26.4 percent, his position has been damaged by revelations that he purchased the stock from a Japanese investor with a reputation for greenmail. Koito's management consistently has charged that Mr. Pickens is interested only in greenmail or is acting as a front for the Japanese greenmailer.

Mr. Pickens' situation has attracted Japanese and American attention -- if for slightly different reasons. In the United States, where the ownership of even big blocks of a publicly traded company's stock easily can change hands and where stock owners have a voice in corporate affairs, the issue is one of fairness and freedom of investment. Koito's treatment of its largest stockholder would be highly unusual in the U.S. context. It smacks of xenophobia and discrimination to Congress and could worsen bilateral ties. In Japan Mr. Pickens' actions are held up as a perfect example of a negative aspect of financial liberalization and internationalization. Mr. Pickens does have his Japanese defenders, however, and even Koito's management acknowledges that Japanese shareholders should be treated with more respect.

There have been other important developments in the area of shareholders' rights that involve only Japanese parties. In a surprise 1989 decision a Japanese court ruled illegal a common antitakeover defense tactic -- the exchange of new shares between target companies at a below-market price in order to dilute the stake of a hostile suitor. As the encounters between *sokaiya* and antinuclear protesters illustrate, stockholder activism (whatever the cause) is increasing gradually. Perhaps the most important development, however, is the revolution in expectations about rates of return on investments sparked by the reform and the liberalization of Japanese financial markets. Not only are individual shareholders griping about the measly dividends offered by publicly traded Japanese companies but institutional investors and the government have added their voices to calls for change (see below), auguring an improvement for Japanese investors in the future.

- Mergers and Acquisitions - The natural extension of the shareholders' rights debate is the discussion over mergers and acquisitions in Japan.

For political as well as economic reasons this debate is of particular interest to the United States. As suggested above, the U.S. market is open to mergers and acquisitions by domestic and foreign investors alike. The pattern of cross- and stable shareholding in Japan, however, reduces the chances to almost nil that an unwelcome bid for a publicly traded Japanese company will succeed. This subject has been broached in bilateral talks and discussed on Capitol Hill.

The Japanese government correctly argues that there are no legal barriers to hostile takeovers in Japan (in fact, as described below, Tokyo has acted to ease rules for public tender offers); the barriers are cultural and not subject to government control. Many Americans and an increasing number of Japanese point out, however, that cross-stockholding is a response to the Antimonopoly Law's ban on holding companies. If this ban were lifted, they argue, Japanese firms would restructure and could become more receptive to mergers and acquisitions. Ironically, the chances that the law will be amended are high currently but for totally unrelated reasons.

- Market Access Issues - Frustrated that the dismantling of Japan's formal trade barriers has not led to more of a spurt in exports, U.S. trade negotiators have focused on the clubby nature of *keiretsu* and other cross-stockholding groups as a major impediment to trade. *Keiretsu* and antitrust policy were mentioned specifically in the June 1990 final report on the Structural Impediments Initiative. ". . . [T]here is a view that certain aspects of *keiretsu* relationships also promote preferential group trade, negatively affect foreign direct investment in Japan, and may give rise to anticompetitive business practices," the Japanese government said in the report. It pledged that antitrust policy would be toughened and foreign direct investment promoted. Because fundamental legal and behavioral changes are involved and since Washington has warned it will monitor Tokyo's actions on this issue, *keiretsu* and cross-stock ownership will be on the bilateral agenda for some time.

Reactions and Responses

Government and private financial analysts have been aware for some time of the multiple consequences of the current pattern of stockholding in Japan, yet only recently have changing international and domestic economic and political environments led to a reconsideration of benefits and costs. As Japan's role in the global economy increases, it is coming under pressure to bring its economic structures, rules and practices more in line with international norms. In order to maintain Japanese access to overseas markets, keep the country's competitive edge, make Japanese markets centers of international activity and spread the nation's wealth more evenly, public and private steps have been taken that may affect the pattern of share ownership in Japan.

- Securities Trading Reforms - In an effort to improve the transparency of trading in Japan, the Ministry of Finance has taken aim at two areas: reducing the role of nonmarket influences and toughening trading regulations. In 1988 MOF issued informal guidelines to limit the influence of any single brokerage house on share prices; brokers were asked to limit their trading of a stock to no more than 30 percent of that issue's monthly trading volume. The MOF guidance has been surprisingly effective; the Big Four's trading volume as a share of total market turnover fell below 40 percent in 1989. The rule worked perhaps too well in early 1990, however, as it hamstrung the Big Four's efforts to support the falling market. MOF has relented on the 30 percent cap for the time being, but it can reimpose the ceiling at any time.

Starting in 1989, tougher insider trading rules have played a major role in MOF's drive to improve the operation of Japan's market. Comprehensive and specific rules as to what constitutes insider trading and harsher penalties at least have drawn a sharp line between legal and illegal activities. Securities firms have responded with their own internal rules, but a number of observers still feel that many gray areas exist. Several investigations and indictments under the new rules have shaken traders and restored some investor confidence.

The governing board of the Tokyo Stock Exchange has buttressed the government's actions on insider trading with complementary changes in rules and regulations. More to the point, the TSE has proposed measures to induce individual investors to move back into stocks, including reducing the minimum size of a trading lot. The current minimum lot is 1,000 shares. (Unlike its New York counterpart, the TSE does not offer odd-lot trading, wherein brokers accumulate orders of less than 100 shares, package them into orders of at least the minimum size and conduct the transaction, thereby permitting investors to buy as little as one share.) Many individuals cannot afford to buy such a large block of stock, especially of desirable, but expensive, blue-chip issues. Since Sony Corp. and Fanuc Ltd. cut their trading minimum to 100 shares, Japanese analysts report that about 65 percent of the turnover in these issues occurs in that size lot. Japanese firms reportedly fear, however, that reducing the minimum lot size will make it easier for sokaiya and others interested in meddling with management policies to gain entry to annual meetings.

With the TSE down sharply from the historic high achieved at yearend 1989 and little optimism that a new bull market will arrive in the near future, the capital gains potential of stock is limited. As a result, the TSE's governing board and the government are urging publicly traded companies to increase their dividends to improve the attractiveness of stocks as an investment. So far both the TSE and the Ministry of Finance have avoided mentioning any specific numbers. Both organizations plan to meet this year with business leaders to discuss the topic. It has been rumored, however, that MOF has told brokers and banks that it will not look favorably on new stock issues that carry low dividends. Again, though, MOF has not specified what constitutes a "low" payout rate.

- Securities Purchase Reforms - In direct response to the Recruit Cosmos Co., Ltd. stock scandal of 1989, government and private regulators have set detailed rules for prepublic-offer private sales of stock, intended to prevent windfall profits. MOF also is debating altering the rules for public offerings that would substitute an open bidding system for the current arrangement of selective placement. Regulators also are modifying the methods of setting prices for newly listed shares, increasing the use of market mechanisms and linking prices more directly to the business fundamentals of issuing firms. Traditionally, a company issuing new shares sets the initial price at a level comparable to that used by other firms of similar financial background in its field, regardless of its business position and prospects. MOF is discussing rules that would set the price according to the issuing company's net assets, net profits and dividend rate.

- Mergers and Acquisitions - MOF has implemented several initiatives in this field. Although public tender offers for a company's stock, a common occurrence in the United States, have been allowed in Japan since 1971, only three such offers ever have been made. (One involved an attempted takeover of a Japanese automotive parts maker by an American firm; the other two were offers by parent companies seeking to take a public subsidiary private.) To improve the chances of success, notification of a tender offer now can be made right before it is announced (versus the prior 10-day notification period). Moreover, the tender offer can last up to 60 days versus the former 30-day limit. (A 20-day minimum still is in effect.) The terms of the offer also can be changed after it has been started (but not after it ends), and it can be withdrawn before its announced closing date. Tendering stockholders also gain better treatment since they can rescind their tender at any time during an offer's life.

To prevent collusive transactions, purchases of 5 percent or more of a publicly traded company's stock must be conducted as a public tender offer except in five special cases. (The most important exception is that this rule does not apply to over-the-counter sales made through a securities firm.) Although this regulation may increase the cost of friendly takeovers because they have to be conducted publicly and on the open market, it also could make unsolicited offers more common since hostile bidders can offer better terms.

Another major change -- the one that forced Mr. Pickens to reveal the source of his Koito stock -- is the so-called 5 percent rule. To discourage stock cornering and other speculative ploys, owners of more than 5 percent of a publicly traded company's shares as of December 1, 1990 have to disclose detailed information to MOF, the company involved and relevant stock exchange officials. These details include shareholders' names, the number and the types of shares held, the shareholders' investment objectives, sources of funds used to purchase the shares and a 60-day trading history. The rule applies to affiliates and other persons closely related to shareholders.

Initial reports from brokers on the 5 percent rule's impact have been positive. According to MOF, 4,474 investors filed disclosures by the December 7, 1990 reporting deadline. While most simply have confirmed well-known relationships, others have proved enlightening, such as Mr. Pickens' dealings with a known speculator. Brokers are confident that greenmail and other speculative ploys will be much less common thanks to the new rule, reducing artificial manipulation of share prices. Both MOF and private observers hope that the disclosure requirements will restore investor confidence in the stock market.

Future Factors

Clearly many steps already have been taken that will affect the pattern of stockholding in Japan. Several issues, however, could have broad influence on future trends:

- Political Fund-Raising - As revealed in the Recruit Cosmos scandal, making contributions to politicians through gifts or sales of stock at below-market prices occurs in Japan. Japanese observers predict that all the new rules and regulations regarding private stock placements and insider trading will not prevent this kind of activity. Although such transactions constitute only a small percentage of total trading, they add significantly to small investors' distrust of the stock market. Prime Minister Toshiki Kaifu has made reform of campaign financing a major goal of his cabinet, but it is unlikely that fundamental changes will be initiated.

- Keiretsu - Japanese debate on this issue is deeply divided between those who stress the "economic rationality" of such an industrial structure and those concerned with improving consumer benefits or smoothing foreign relations. Many Japanese attribute at least some of the nation's rapid economic reconstruction and current international competitiveness to the keiretsu system. Closer to the heart, corporate groupings echo the group-oriented nature of Japanese society. If Japan expects to harmonize its economy with the global economy, the nation must address the issue of exclusive economic groups.

- Government Attitudes Toward Producers and Consumers - To accelerate postwar economic reconstruction, Tokyo's fiscal and monetary policies were canted toward producers to the detriment of consumers. Only in the past few years have concerns about the quality of life in Japan and the sources of the country's economic growth forced Tokyo to reconsider policies that served the nation so well. Stronger protection for small investors and beefed-up shareholders' rights are two possible expressions of a more balanced approach to the demands of consumers and producers.

- Financial Liberalization and Regulation - Already having had a major impact on stockholder and stock issuer behavior, Tokyo's drive to reform and restructure Japan's financial markets still has the greatest potential to alter the current pattern of share ownership. For example, to address the remaining barriers between commercial and investment banking, MOF is considering dropping the Antimonopoly Law's ban on holding companies; that move would affect many shareholding-related issues. Even now tougher financial competition among lenders as well as borrowers is putting strain on traditional business practices, such as keiretsu and cross- and stable shareholding. With the bottom line becoming more important as competition heightens, maintaining friendly business ties is starting to lose its priority. The growing presence of foreign firms also could shake up the Japanese market as they introduce new ideas and practices, such as foreign brokers' active use of computer-driven index arbitrage trading strategies.

Of less certain impact is the government's campaign to crack down on insider trading and other forms of market manipulation. Even before the ink was dry, some Japanese analysts labeled the new insider trading rules ineffective and impotent. Revealingly perhaps, local prosecutors, rather than the Ministry of Finance, have initiated investigations under the new rules.

Two areas should be of particular interest in the future. The nascent movement for greater shareholders' rights could be the first sign that the pro-producer attitudes of the government and of the common citizen may be changing. Such a shift, if it becomes widespread, will have implications far beyond stockholding patterns. The other point of interest will be the behavior of big and small investors if a bear market continues for an extended period of time. Predicting investor behavior in a boom market is not a difficult task given the strong group mentality of the average Japanese. A falling market, in contrast, is a true test of investor mettle and of assertions that small investors reduce market volatility.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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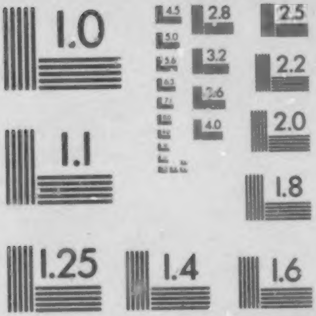
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JEI

REPORT

A Two-Part Report: A and B

NO. 4A February 1, 1991

ECONOMIC EQUALITY IN JAPAN

Summary

Although Japan's economy sometimes seems very different from that of other industrial countries, it manages to do quite well in spreading broadly the benefits of growth. Very few people are truly poor and, even within the large middle class, incomes are comparatively similar. Equally important, Japanese households overwhelmingly place themselves in the middle class. The country's relatively equal income distribution has been achieved without having to redistribute income extensively, suggesting that Japan has avoided the alleged trade-off between economic equality and growth.

Some Japanese analysts have stressed the potential for inequality arising from the run-up in land and stock prices in the late 1980s. This process, however, so far has resulted in relatively small changes and already may be in the early stages of reversal.

Introduction

Japan is now among the wealthiest nations on earth. Measured in national currencies at then current exchange rates, Japan's per capita income in 1988 (the most recent year for which comparable data are available) ranked third behind Switzerland and Luxembourg among the 24 member nations of the Organization for Economic Cooperation and Development; the United States ranked sixth. Once differences in price levels are taken into account, however, Japan's real income per capita still does not equal that of the United States, although it now exceeds that of a number of European nations (see Table 1).

Table 1: International Comparisons of Income

(per capita gross domestic product where United States=100*)

	1970	1975	1980	1984	1985	1986	1987
Japan	65	70	77	81	82	82	83
Great Britain	79	83	81	80	80	81	82
Canada	79	90	93	92	93	93	94
West Germany	103	105	112	110	109	109	109
France	95	102	104	102	100	100	99
Italy	62	64	68	67	67	68	68

*1980 prices and 1980 exchange rates.

Source: Organization for Economic Cooperation and Development

Of course, in Japan and elsewhere not everyone shares the bounty equally. Philosophers, economists and others have debated for centuries whether it matters how a nation's economic pie is divided. Some experts argue that equality of opportunity to get rich -- not the result -- is the appropriate basis for economic policy. They suggest that the means to achieve the end result of greater equality, typically taxes and welfare schemes, reduce the incentive to work, thereby trimming the size of the pie to be distributed. A handful go farther, suggesting that economic inequality is preferable because it puts income in the hands of those in a position to save and thereby eventually increases the total amount to be distributed.

Many others, however, believe that equality of economic result, while perhaps reducing work incentives somewhat, is a laudable objective. In part, this view stems from widespread beliefs about helping the unfortunate and, in part, from a pragmatic concern that economic activity proceeds with fewer disruptions and higher productivity if everyone has a sense that the system works to his or her benefit.

Individual Japanese may attach more weight to economic equality -- and be more prone to react negatively if apparently deprived of it unfairly -- than their counterparts elsewhere. Many analysts, both Japanese and foreign, believe that the Japanese population has a strong urge toward uniformity -- to be like one's neighbor -- as encapsulated in the Japanese saying, "a nail that sticks out gets hammered down." In an economic context, an American might call this desire "keeping up with the Joneses." In a political sense, this factor may imply increased attention to economic equality.

Repeated surveys reveal that the Japanese believe that their economic system works to put them on a par with their neighbor. Although members of a slowly expanding group regard themselves as falling within the lower class, an overwhelming number still label themselves members of the middle class (see Table 2). Supporting this prevalent view, a wide range of consumer goods are

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Table 2: Survey on Class Status

Survey Date	Upper Class	Upper-Middle Class	Middle-Middle Class	Lower-Middle Class	Lower Class	Don't Know
1960	0.4%	3.9%	40.8%	31.5%	13.6%	9.9%
1965	0.6	7.3	50.0	29.2	8.4	4.5
1970	0.6	7.8	56.8	24.9	6.6	3.3
1975	0.6	7.9	60.4	22.4	5.1	3.6
1980	0.6	7.4	54.4	27.5	6.7	3.3
1985	0.5	6.4	53.7	28.4	8.1	2.8
1989	0.5	6.7	52.1	28.5	8.8	3.3

Source: Management and Coordination Agency

within the financial means of virtually every household. For example, while many of the world's households still have to make do without their own television set, 99.4 percent of Japanese households had color TVs in 1990 and 66.8 percent had videocassette recorders, according to the Economic Planning Agency. Some experts argue that this self-perception -- and reality -- of a middle-class society has been a key to Japan's overall economic performance because it has given the general population a sense that its hard work is rewarded. In any event, as will be shown below, the causation may have worked in reverse as well; economic growth has led to more equal incomes. In that respect, Japan's experience mirrors that of other industrial nations.

Income Equality in International Perspective

In the long march of human history, not only have average incomes risen, they have become more equal, meaning that the number of poor has been reduced significantly. During the past hundred years, for example, practically every country has experienced a narrowing of differences between the poor and the rich. In addition, wealthier countries generally have more equal incomes than those that are poorer, holding out the prospect that economic development, if successful, would increase everyone's incomes. Such an outcome is dramatic rebuttal to those who argued in the 19th century that a widening gap between the haves and the have-nots would be an inevitable consequence of industrialization.

Japan is the exception that proves the rule in this story of human progress. Although arguably either the last of the original group of industrial nations or the first of the latecomers, Japan's experience matches that of other countries. By most accounts, Japan's high rate of economic growth in the postwar period brought with it not only an increase in total national income but also a narrowing of income differences, although the period also included interludes when the differential widened. Table 3 shows the results of various Economic Planning Agency calculations of income equality; generally it shows little movement since 1970, with two of the measures hitting a low (greatest income equality) in 1979 and 1980 and the remaining two showing a slight increase in inequality between 1970 and 1989.[1]

Table 3: Measures of Income Inequality in Japan

(Gini coefficients*)

	Based on Savings Survey		Based on Family Income and Expenditure Survey	
	All Households	Wage Earners' Disposable Income	All Households	Wage Earners' Disposable Income
1970	0.2669	0.1668	0.2533	0.1787
1971	0.2748	0.1670	0.2587	0.1788
1972	0.2705	0.1672	0.2562	0.1797
1973	0.2736	0.1673	0.2606	0.1792
1974	0.2771	0.1777	0.2686	0.1879
1975	0.2742	0.1804	0.2765	0.1883
1976	0.2771	0.1746	0.2666	0.1861
1977	0.2760	0.1709	0.2578	0.1844
1978	0.2655	0.1752	0.2644	0.1879
1979	0.2679	0.1662	0.2587	0.1799
1980	0.2596	0.1677	0.2599	0.1832
1981	0.2620	0.1719	0.2592	0.1872
1982	0.2601	0.1697	0.2642	0.1872
1983	0.2652	0.1698	0.2618	0.1881
1984	0.2725	0.1700	0.2598	0.1878
1985	0.2785	0.1779	0.2713	0.1973
1986	0.2812	0.1758	0.2774	0.1965
1987	0.2845	0.1798	0.2728	0.1987
1988	0.2814	0.1787	0.2681	0.1981
1989	0.2894	0.1794	0.2726	0.1965

*Gini coefficients are a widely used measure of income inequality. They range from zero (for perfect equality) to 1 (national income is concentrated in one person). Higher figures correspond to greater inequality. For explanations of various Gini measures, see Malcom Sawyer, "Income Distribution in OECD Countries," OECD Economic Outlook Occasional Studies, July 1976, p. 19. The Economic Planning Agency's measure shows greater equality in Japan vis-a-vis other nations than do most of the alternatives discussed in Sawyer's article.

Source: Economic Planning Agency, Keizai Hakusho (Tokyo: Okura-sho Insatsu Kyokyu, 1990), p. 529.

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[1] For details of income distribution during the prewar period and the postwar period through the 1970s, see Akira Ono and Tsunehiko Watanabe, "Changes in Income Equality in the Japanese Economy," in Hugh Patrick (ed.), Japanese Industrialization and Its Social Consequences (Berkeley, California: University of California Press, 1976), pp. 363-389. See also Martin Bronfenbrenner and Yasukichi Yasuba, "Economic Welfare," in Kozo Yamamura and Yasukichi Yasuba (eds.), The Political Economy of Japan, Volume I: The Domestic Transformation (Stanford, California: Stanford University Press, 1987), pp. 108-114.

By the mid-1970s Japan had another accomplishment to its credit. Although at the time incomes still lagged those in other industrial countries, they were in several instances more equal in Japan. International comparisons are difficult because nations employ varying ways of collecting data and aggregate the data in different ways to come up with measures of inequality. A mid-1970s survey that took account of these differences but had to use different years for each country found that by seven different possible measures of inequality, after-tax incomes in Japan in 1969 were more equal than those of the United States in 1972. Japan's level of inequality was generally comparable to European countries', with incomes more equal than those of France or West Germany but less than Great Britain and Sweden by most measures.[2]

The Economic Planning Agency recently compiled data on income distribution through the late 1980s. A number of analysts have cautioned that high-income Japanese households tend to underreport their income, biasing the Japanese measures toward apparent income equality. For this and other reasons the data may not accurately measure differences in inequality across countries; the figures probably are most reliable for comparisons of a given country over time (see Table 4). Bearing this caveat in mind, the EPA data suggest that recent years have shown little change in income distribution in Japan or the other countries listed.[3]

Table 4: International Comparisons of Income Equality

(Gini coefficients)

	1975	1980	1985	1986	1987	1988	1989
Japan	0.2765	0.2599	0.2713	0.2774	0.2728	0.2681	0.2726
United States	0.3348	0.3425	0.3640	0.3660	0.3656	n.a.	n.a.
Great Britain	0.3254	0.3363	0.3719	0.3796	0.3883	n.a.	n.a.
West Germany	n.a.	0.5108	0.4881	n.a.	n.a.	n.a.	n.a.

Source: Economic Planning Agency, Keizai Hakusho (Tokyo: Okura-sho Insatsu Kyokyu, 1990), p. 271.

Other data are supportive of the difficult-to-interpret Gini coefficients shown in Tables 3 and 4. Between 1980 and 1989, for example, of five income groups in Japan, pretax incomes of those in the top group widened from being 2.65 times as high as those at the bottom to being 2.9 times as high. In the United States money incomes of those at the top of the fourth category (out of five) jumped from being 3.36 times as high as those at the top of the poorest category in 1980 to 3.67 times as high in 1987.

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[2] Malcom Sawyer, "Income Distribution in OECD Countries," OECD Economic Outlook Occasional Studies. July 1976, p. 19.

[3] The data in Table 4 suggesting greater inequality in the United States are consistent with other data showing an increase in real per capita income between 1980 and 1988 but also an increase in the percentage of the population living in poverty. Studies of income distribution in the United States are voluminous. Two relatively recent efforts include Frank Levy, Dollars and Dreams: The Changing American Income Distribution (New York: Norton, 1987), and Charles M. Beach, "Dollars and Dreams: A Reduced Middle Class? Alternative Explanations," Journal of Human Resources, Winter 1989, pp. 162-193.

Sources of Inequality

Adherents of redistributing income sometimes argue as follows. Those who work for a living receive far lower incomes than those who receive income from real or financial property. This is unfair because such honest labor should receive much higher compensation. Furthermore, this difference between workers and capitalists is widening, suggesting that unfairness is also broader than previously.

The facts supporting this argument are not altogether incorrect as far as Japan is concerned. According to the 1989 Report on the Family Income and Expenditure Survey of all households, the ones in the bottom 20 percentile of the income distribution consisted mostly of people who either worked as laborers or had no jobs. By contrast, households in the top 20 percentile mostly were made up of corporate managers or corporate staff, although blue-collar workers and people who were unemployed or not in the labor force constituted 13.7 percent of this group. Among worker households, higher income groups received a larger percentage of their total income from returns on financial and nonfinancial assets. (Data on property income for nonworker households are not available on a comparable basis.)

However, the argument is wrong concerning the trend over time. At least since the mid-1970s income from labor has changed little as a percentage of Japanese national income (see Table 5). As such, the data confirm the near-stability during this period of the Gini coefficient of income. The stability of labor's relative share is even greater if individual proprietorship income, arguably partly income in-kind to family members, is classified as employee compensation instead of business income. On this basis, employee compensation as

Table 5: Distribution of National Income

	1970	1975	1980	1985	1986	1987	1988
Compensation of Employees	54.0%	67.5%	66.8%	68.8%	69.2%	69.8%	69.9%
Income from Financial and Nonfinancial Assets	8.3	10.9	10.6	9.7	10.0	9.5	9.5
Business Income*	37.7	21.6	22.6	21.4	20.8	20.7	20.6

*Private corporations, public corporations and individual proprietorships. Net of dividend receipts and payments.

Source: Economic Planning Agency, Annual Report on National Accounts (Tokyo: Okura-sho Insatsu Kyokyu, 1990), pp. 146-149.

a percentage of the total rose from 74.9 percent in 1970 to a peak of 84.1 percent in 1975 during the first oil shock before stablilizing at a value between 79.5 percent and 80.9 percent between 1980 and 1988, the latest year for which data are available.

The change -- or the lack of change -- in the distribution of income between employees and businesses, however, says relatively little by itself since the composition of the labor force also was changing. More educated or more senior workers earn higher wages than those with less education or seniority. This fact suggests that changes in the composition of the labor force may explain a substantial part of the modest reduction in income equality since 1970; Japan's increasingly old and well-educated labor force could be expected to receive higher wages, other factors, including the tightness of labor markets, remaining equal.

At least in recent years the educational factor explains a good deal of the rise in wages. More educated workers get higher wages and part of the large overall wage gain is a consequence of a higher percentage of the work force having substantial education. In fact, average overall wages would have risen during the post-war period even if the wages for a worker with a given level of education had remained the same. As shown in Table 6, if one concentrates on the wages of a male worker of a given age with a given degree of seniority and education, the rate of wage increase for both college-educated workers and those with only a high school education is less than the group of 35- to 39-year-old males as a whole. However, if one also looks at overall wages for males at all levels of seniority and wages, wage gains are the greatest of all. This implies that seniority is increasing, that the age composition of the labor force favors higher wages, or both.

The table shows that, adjusted for sex, age, experience and education, wage gains were minimal between 1985 and 1988 for both college-educated workers and high school graduates. Annual inflation, measured by the consumer price index, varied between 0.1 and 0.7 percent in the 1986-88 period, suggesting that the increases were even smaller than shown. Since real national income grew, the proportion going toward employee compensation might have shrunk had it not been for changes in the composition of the labor force.

Table 6 allows yet another dimension of income equality to be explored. Throughout most of the period studied the wages of high school graduates, controlled for seniority, sex and age, gained on those of college graduates, as shown by the generally diminishing ratio of average wages for the two groups. This suggests a more equal income distribution across groups of people with varying degrees of education.

Incomes also differ by region within Japan. As farmers' incomes have risen relative to those of other groups during the postwar period, regional differences generally have narrowed. However, wages have not shown a similar pattern. Wages in Tokyo always are the highest; compared to the lowest, they were 53 percent higher in both 1963 (when Tottori prefecture had the lowest) and 1988 (when Akita prefecture had that distinction). In the intervening years the differential varied only slightly from this figure. Of course, some of the difference is eaten up by higher living costs in Tokyo, but the low-wage prefectures generally still have outmigration, suggesting that higher prices do not completely offset the advantages of Tokyo and other high-wage areas.

Table 6: Wages for Selected Types of Workers

	1976	1985	1986	1987	1988
35- to 39-Year-Old Males With 5 to 9 Years of Experience					
College-Educated					
Wages*	Y209.8	Y301.4	Y299.9	Y300.7	Y307.0
Change**	n.a.	4.1%	-0.5%	0.2%	2.1%
High School Graduate					
Wages*	Y162.4	Y236.0	Y239.9	Y239.1	Y247.5
Change**	n.a.	4.2%	1.7%	-0.3%	3.5%
Overall***					
Wages*	Y159.7	Y246.8	Y248.2	Y250.5	Y259.5
Change**	n.a.	5.0%	0.6%	0.9%	3.6%
College-Educated as Multiple of High School Graduate Wages	1.29	1.28	1.25	1.26	1.24
All Male Workers					
Wages*	Y151.5	Y244.6	Y252.4	Y257.7	Y264.4
Change**	n.a.	5.5%	3.2%	2.1%	2.6%

*Monthly scheduled wages in thousands of yen.
**Annualized year-to-year rate for 1986, 1987 and 1988 and average annualized 1976-85 rate for 1985.
***Includes college-educated, junior college graduates, high school graduates and those with only elementary or junior high school education.

Source: Ministry of Labor, Yearbook of Labor Statistics (Tokyo: Rodo Horei Kyokai, various years).

Asset Inequality

Most European and American economists have stressed income differences as the most important dimension of economic inequality. Japanese analysts, however, increasingly focus on a different criterion: asset inequality.[4] If land, housing and financial assets are concentrated in relatively few hands, then the remainder of the population may feel disadvantaged, even if incomes in the two groups are roughly comparable.

Rising land prices have given this concern new emphasis in recent years as many households, especially young ones, have been unable to buy their own homes. (For details of Japan's housing situation, see JEI Report No. 30A, August 4, 1989.) In other instances people have been able to buy homes but not the land on which the housing sits. For example, a 1988 survey showed that of the people owning a detached house, condominium or other unit in Tokyo, 41.7 percent owned the land as well, down 2.7 percentage points from the previous survey five years earlier.[5] According to EPA, Gini coefficients of inequality in the value of residential land holdings containing a house jumped from 0.44 in 1986 to 0.54 in 1988 before declining to 0.52 in 1989 and 1990. Similarly, the Gini coefficient of total financial assets rose steadily from 0.49 in 1981 to 0.52 in 1989.[6]

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[4] For an example, see Tachibanaki Toshiaki, "Japan's New Policy Agenda: Coping With Unequal Asset Distribution," Journal of Japanese Studies (Summer 1989), pp. 345-369.

All these figures are substantially higher than the income Gini coefficients found in Tables 3 and 4. What these numbers mean is that land and financial assets are less equally distributed than income. Apparently soaring land and stock prices in the late 1980s had the effect of widening the differences. While Japanese analysts tend to view such trends with some alarm, the events of 1990 may allow them to relax some, at least on the question of financial assets. The sharp decline of the Tokyo Stock Exchange and other stock markets wiped out a significant part of the wealth of people owning securities compared to their generally poorer counterparts who keep their financial assets in the form of savings accounts; that helped reduce inequality of financial assets. If, as many analysts believe, land prices are likely to at least level off, more people may be able to afford to buy land and a house, spreading the distribution of these assets more evenly.

Unequal asset distribution is not confined to Japan. According to the Department of Commerce's Bureau of the Census, the wealthiest 3 percent of American households hold approximately 27 percent of the net worth in the United States, although Census says that it observed little change in these 1988 figures and those in its earlier survey for 1984. These figures are not directly comparable to the ones cited above for Japan, but few people should be surprised by the apparent result that the concentration of wealth is more constant in this country than in Japan. Land constitutes a smaller percentage of total wealth in the United States, and both real assets and financial assets have fluctuated less in value in recent years than in Japan.

Equality in a Broader Perspective

Having relatively equal incomes does not ensure economic equality in the broader sense. Obviously, equal ability to earn income -- as a result of access to education, financial and nonfinancial assets or for other reasons -- also is important. High-quality education is almost universally available in Japan, although access to the best schools is sharply limited. A high savings rate has given many Japanese households a stake in financial markets, even if asset distribution is uneven. Important groups, of which women constitute the largest, are denied full opportunity, however, to pursue economic gain.

Japan's relatively undeveloped public infrastructure and low level of publicly provided services may reduce that country's economic equality compared to that of other nations. Americans, for example, have readier access to good

[5] Management and Coordination Agency, Jutaku Tokei Chosa, as cited in Economic Planning Agency, Keizai Hakusho (Tokyo: Okura-sho Insatsu-kyoku, 1990), p. 263.

[6] Ibid., p. 528.

public libaries than do their Japanese counterparts. Similarly, urban park space is scarcer in Japan. New York City, for example, has nine times the parkland per capita of Tokyo while Paris has almost six times as much. Japanese households also pay a higher proportion of the total educational costs of their own children than their American counterparts, but they receive more help from their government and employers in meeting medical costs.

Implications of Japan's Inequality

On balance, the figures suggest that the benefits of Japan's strong postwar economic performance have been widely shared. This result, as noted above, has ample historic precedent: greater equality typically is the result of economic growth, particularly for countries joining the ranks of industrialized nations.

Japan has achieved a measure of economic equality -- both on a pretax and an after-tax basis -- without unusual resort to welfare schemes that tax the rich to aid the poor. Government outlays as a percentage of gross national product came to 32.9 percent in 1988, the lowest except for Switzerland of any of the 18 reporting OECD countries. Similarly, Japan's government receipts represented 34.3 percent of GNP, second lowest behind the United States. By contrast, Sweden, a country widely regarded as having a relatively equal income distribution, had government outlays of 59.4 percent of GNP and receipts of 61.9 percent.

In addition, the results for Japan may surprise analysts who have claimed that economic policies in Japan have been directed toward the producer rather than the consumer. For example, rather than encouraging competition and the low prices that it would bring, economic policies supposedly are directed toward protecting firms and their profits, even at the expense of competition. This line of reasoning would appear to suggest that incomes are more unequal in Japan than elsewhere since high profits would concentrate incomes in the hands of relatively few producers. This argument is belied by the facts; incomes probably are more equal in Japan than in the United States, although they may be more unequal than in some European countries.

While Japanese economic policymakers in fact may have been more oriented toward the producer than the consumer, the dichotomy is not relevant because virtually everyone is both a producer and a consumer. Protected firms can pay their workers higher wages or invest in more or improved capacity, leading to higher production, lower consumer prices and increased labor demand down the road. Moreover, some policies have favored industries or firms that otherwise would have contracted. These measures, which involved picking "losers," may have had the additional effect of minimizing wage declines in the affected industries.

The results for Japan also demonstate the importance of education. As noted in Table 6, wages in Japan went up in large measure because of structural changes in the labor force; workers received more education and got older. Although the table suggests that college graduates actually had years of declining nominal wages once the effect of seniority is removed, the increase in the number of workers with higher education was enough to pull up overall nominal wages. In addition, the large rise in college graduates appeared to improve the supply-demand balance for those without college degrees; as high school graduates became relatively scarce, their incomes relative to those of college graduates rose. For the United States, with its problems of finding meaningful work for those without advanced education, this finding is potentially significant.

Some widely held beliefs get little support from the results for Japan. Since at least the early 19th century, some economists have believed that a high savings rate depends on an unequal income distribution. They have based their argument on the theory that only the relatively affluent can afford to save. In Japan, as in other countries, the data appear to show that savings rates are higher for the wealthy; in 1987 the highest income group saved as much as twice as high a percentage of their income as those in the poorest group. Yet Japan has among the world's highest personal savings rates and an income distribution arguably more even than in most other countries; that suggests that an unequal income distribution is not necessary for a high savings rate.

This conclusion on savings leads to an important caveat in interpreting the data. To some extent high incomes and savings rates reflect a stage in an individual's life, a typical example being a family with the principal breadwinner in his or her peak earning years saving for the children's education and marriage expenses. As Japan's society ages, people in this stage of their life will decline as a percentage of the population, arguably reducing both income differentials and overall savings rates.

Conclusion

The relative equality of incomes in Japan should be somewhat reassuring to Americans. The conventional wisdom that Japanese multinational corporations have virtually unlimited funds to buy whatever they want at home or abroad might lead to the conclusion that the Japanese consumer/wage earner is getting the short end of the stick, but studies of income suggest that the individual Japanese probably is getting his or her share as well. This finding indicates that, for all the apparent differences, in many critical respects the Japanese economy is not as dissimilar from that of other industrial nations as it appears.

For further information, contact Douglas Ostrom.

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Japan's Trade Surplus Drops Again In 1990

Four years ago many American observers doubted that Japan's trade imbalance ever would show a sustained decline over several years. On the contrary, they believed, the surplus would rise inexorably. Even the drop in the value of the dollar that began in 1985 initially appeared to be counterproductive inasmuch as the surplus soared in 1986. Since 1987, however, the surplus has declined steadily. The 1990 customs-clearance trade figures from the Ministry of Finance put the dollar-denominated surplus down 18.5 percent from 1989's number and at its lowest level since 1985's $46.1 billion outcome (see Table). The downward trend continued in the final quarter of 1990; the 24.5 percent drop on a year-to-year basis in the September-December period was enough to reduce the fourth-quarter imbalance to the lowest level since 1983.

In declining in each of the last four years, net exports reversed the upward movement evident during most of the postwar period; never before during this period had the imbalance shown more than three straight years of decline. (Japan's current account, a broader measure that reflects trade in services as well as trade in goods, has shown a similar trend.) Although the surplus remains high by historical standards, its four-year drop offers partial vindication to those economists who consistently predicted that the surplus would head downward as the weak dollar made Japanese exports more expensive and imports cheaper. The apparent increase in the surplus in 1985 and 1986, they noted, was a temporary phenomenon arising from exports and imports being valued in cheaper dollars. As the American currency weakened, more dollars were required to represent a given transaction. This fact tended to increase the dollar value of both exports and imports and, because sales abroad initially were larger than purchases overseas, the apparent size of the imbalance. Only in 1987 did the surplus begin falling as measured in dollars, although it dropped in real or volume terms somewhat earlier.

However, the economists' explanation carried an important caveat. Only when other factors were equal would the scenario necessarily unfold as envisaged. Since 1987 other factors have varied, with the effect that the decline in the surplus, while consistent, occasionally has seemed incredibly slow for those who bought the economists' argument. The data for 1990 demonstrate how these other factors have mattered.

For example, the dollar has moved erratically against the yen since 1985. True, it rapidly sank in value through early 1988, but since then the course of the dollar-yen exchange rate has been more unpredictable. In 1989 and part of 1990 the American currency appreciated against the yen. As a result, the decline in the surplus over the short term was exaggerated compared to long-term trends, just as the rise in the surplus in 1985 and 1986 had been. Conversely, the dollar's 1989-1990 rebound appeared to jeopardize the long-term continuation of the decline in Japan's surplus. In 1990 Japanese exports increased 5.6 percent in volume terms, almost as sharp an advance as the real growth in imports, which rose 6 percent. By itself, this development would have meant a bigger surplus, since exports still are larger than imports. However, the price of imports in both dollars and yen increased faster; therefore, imports expanded more than exports.

Last year's near-equal increase of real imports and exports should give pause. Could the 1986 pessimists concerning Japan's surplus be proven correct after all? Probably not. The 1990 trade figures resulted from a combination of a weakening dollar between 1985 and the spring of 1988 and a strengthening dollar from early 1989 until mid-1990. However, in late 1990 and early 1991 the dollar's fortunes reversed again as the American currency sagged against the yen and other currencies. If post-1985 history repeats itself, this development suggests that the surplus in volume terms soon will be heading down again, other factors being equal. But could other factors swamp this effect? Probably not; more likely they will push in the same direction. For example, the weakening U.S. economy will tend to lead to smaller Japanese exports here and to other countries that have a close connection to the U.S. economy. If, as most experts expect, the still-growing Japanese economy continues to pull in more imports, then the surplus would decline even without a change in exchange rates.

The weakness of the American economy was evident in the 1990 figures for U.S.-Japan trade. While imports from the United States continued to rise, dollar-denominated exports to this country showed a rare 3.1 percent drop last year. As a result, the bilateral dollar-denominated trade surplus dipped 15.4 percent to its lowest level since 1984. Should the U.S. recession deepen and Japanese economic growth continue, the same trends could be evident in 1991.

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$209,151	19.1%	$126,408	-2.4%	$82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1989	275,175	3.9	210,847	12.5	64,328
1990 (p)	286,965	4.3	234,566	11.2	52,399
1988: I	60,279	17.1	44,505	39.2	15,774
II	65,179	14.5	47,260	29.9	17,919
III	67,169	16.1	47,258	23.2	19,911
IV	72,291	14.8	48,331	12.9	23,960
1989: I	68,227	13.2	51,142	14.9	17,085
II	67,602	3.7	51,292	8.5	16,310
III	69,595	3.6	53,048	12.3	16,547
IV	69,751	-3.5	55,364	14.6	14,387
1990: I	66,718	-2.2	54,303	6.2	12,416
II	67,244	-0.5	53,900	5.1	13,344
III	72,244	3.8	56,473	6.5	15,771
IV (p)	80,759	15.8	69,890	26.2	10,869

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y35,290	-15.9%	Y21,551	-30.7%	Y13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1989	37,823	11.4	28,979	20.7	8,844
1990 (p)	41,461	9.6	33,820	16.7	7,641
1988: I	7,713	-3.1	5,688	14.7	2,025
II	8,163	0.1	5,918	13.6	2,246
III	8,924	4.9	6,280	11.3	2,644
IV	9,139	5.1	6,121	3.3	3,018
1989: I	8,705	12.9	6,516	14.6	2,189
II	9,222	13.0	6,997	18.2	2,225
III	9,911	11.0	7,547	20.2	2,363
IV	9,985	9.3	7,919	29.4	2,067
1990: I	9,767	12.2	7,929	21.7	1,838
II	10,451	13.3	8,383	19.8	2,067
III	10,659	7.5	8,353	10.7	2,306
IV (p)	10,584	6.0	9,155	15.6	1,429

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$80,456	23.3%	$29,054	12.6%	$51,401
1987	83,580	3.9	31,491	8.4	52,090
1988	89,634	7.2	42,037	33.5	47,597
1989	93,189	4.0	48,246	14.8	44,943
1990 (p)	90,312	-3.1	52,286	8.4	38,026
1988: I	19,859	10.3	10,090	44.4	9,769
II	21,610	2.0	10,458	37.8	11,152
III	23,056	6.6	10,667	29.3	12,389
IV	25,109	10.3	10,821	25.0	14,288
1989: I	22,726	14.4	11,599	15.0	11,127
II	22,997	6.4	12,064	15.4	10,933
III	24,117	4.6	12,462	16.8	11,655
IV	23,347	-7.0	12,120	12.0	11,227
1990: I	21,664	-4.7	12,728	9.7	8,936
II	20,938	-9.0	12,842	6.5	8,096
III	22,941	-4.9	12,719	2.1	10,222
IV (p)	24,769	6.1	13,997	15.5	10,772

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y13,564	-13.0%	Y4,918	-20.9%	Y8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988	11,487	-5.4	5,388	17.6	6,099
1989	12,816	11.6	6,632	23.1	6,184
1990 (p)	13,055	1.9	7,575	14.2	5,480
1988: I	2,541	-8.8	1,290	19.1	1,251
II	2,706	-10.8	1,309	20.5	1,397
III	3,063	-3.6	1,418	16.7	1,645
IV	3,177	0.9	1,371	14.4	1,806
1989: I	2,899	14.1	1,478	14.6	1,421
II	3,139	16.0	1,648	25.9	1,491
III	3,436	12.2	1,773	25.0	1,663
IV	3,342	5.2	1,733	26.4	1,609
1990: I	3,171	9.4	1,859	25.8	1,312
II	3,254	3.7	1,997	21.1	1,257
III	3,384	-1.5	1,884	6.3	1,500
IV (p)	3,246	-2.9	1,835	5.9	1,411

On balance the 1990 data, taken together with earlier figures, suggest that Japan's trade structure is sensitive to exchange rates, but the complicated connection has led many analysts in recent years to dismiss the effect entirely and others to make too-confident predictions about the early demise of Japan's trade surplus. The early trends for 1991 suggest that another chunk could be taken out of the surplus this year.

Douglas Ostrom

Government Unveils Land Reform Package

The cabinet of Prime Minister Toshiki Kaifu adopted a land reform program January 25 that stresses the necessity of reducing land prices and defining appropriate land uses to expand the supply of land for housing. In a policy speech before the Diet the same day Mr. Kaifu emphasized that land reform would be a top domestic priority this year from both the supply and the demand angle. To this end the government will review the use of farm land within metropolitan areas for housing, revise the assessments used for national property taxes and redraft the laws governing landlord-tenant relations. It also will urge local authorities to monitor land deals more effectively, watching for rapid price increases. Tokyo plans as well to continue to jawbone lenders to restrict loans for speculative real estate transactions. In line with the cabinet decision the Economic Planning Agency is studying the possibility of creating a monthly land price index to serve as an early warning system of rapid increases in property prices.

A Ministry of Construction advisory panel on city planning that is looking at farm land within urban areas has recommended in principle that local governments use their authority to convert most farm land within city limits to sites for housing and public facilities. Its January 23 report suggested, however, that some urban farm land be preserved as green spaces. The ministry plans to submit legislation to the current Diet session to facilitate the use of urban farm land for residential purposes and, at the same time, to give tax breaks for qualified "productive green space." The proposed changes would enlarge the opportunities for serious farmers to qualify their land as "productive green space" and thus get favorable tax treatment; those who do not qualify would face higher taxes.

In line with earlier attempts to narrow the gap between actual real estate prices and appraised values, the National Tax Administration Agency on January 22 boosted the values it uses to assess inheritance and gift taxes on real estate. The average 38.1 percent jump in 1990 for the country's 47 prefectural capitals represented the biggest adjustment since a 42 percent hike in 1962 and topped 1989's increase by 9.1 percentage points. The rise in assessments for Tokyo and Yokohama was relatively small -- up 17.5 percent and 16.1 percent, respectively, although these areas experienced soaring property values in previous years. This time the largest increases were in the Kansai area (the western part of Japan), with assessments climbing 87 percent in Otsu, Shiga prefecture, 78.8 percent in Nara and 76.7 percent in Okayama. NTAA hopes the higher land valuations will help prevent speculation and thus dampen the rise in real estate prices. Critics note, however, that since the higher assessments will mean higher transfer taxes, more land will be sold at prices that only large corporations can afford. However, the prospect of a higher future tax payment can be expected to immediately drop the price of the property by the present value of that tax.

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New Directions For Japanese Monetary Policy?

The next move is up to Japan. That conclusion appeared inescapable when the United States reduced its discount rate half a percentage point February 1, a day after Germany, increasingly the economic policy pacesetter in Europe, raised its rate a like amount. Tokyo's three choices are either to go with Washington's antirecessionary strategy, to follow Bonn in emphasizing the fight against inflation, or to hold its current course of comparatively tight money. For the Bank of Japan, which has a recent record of deft hands-on calibration of monetary policy, the choice will not be easy.

In making a decision BOJ will have to weigh several factors; among the most important of these will be the effect on currency markets. The value of the Japanese currency generally has risen since the August 2 Iraqi invasion of Kuwait. Although the yen slumped in the closing days of 1990, it rose again in early February, closing February 11 at Y127.9=$1.00, less than 8 yen short of its all-time high set in November 1988.

Also on February 5 Sen. John Heinz (R, Pa.), backed by colleagues including Sens. Lloyd Bentsen (D, Texas), Donald Riegle (D, Mich.) and Jake Garn (R, Utah), submitted a modified version of legislation he proposed last year to amend the Foreign Agents Registration Act. S 346 would "increase disclosure of foreign lobbying and propaganda activity and would improve our ability to achieve that objective through better enforcement," Sen. Heinz said. The measure would broaden the definition of those required to register as foreign agents, specifically adding foreign-controlled U.S. subsidiaries as well as lawyers acting on behalf of foreign interests in administrative or judicial proceedings. Language not included in last year's bill also narrows the current registration exemption that allows representatives of foreign-owned U.S. subsidiaries to avoid registration by claiming to be engaged in commercial, rather than lobbying, activities. Another provision in the bill would standardize reporting dates for registered agents to help facilitate analysis of information supplied to the Department of Justice. S 346 also seeks to improve compliance with registration and reporting regulations by augmenting the enforcement powers and penalties currently available to Justice.

Outlining the rationale for such bills, supporters voiced concerns on the Senate floor about perceived economic threats from abroad and the need to ensure that American policy debates are not unduly influenced by foreign interests. Mr. Heinz noted that Sen. Claiborne Pell (D, R.I.), chairman of the Senate Committee on Foreign Relations, had indicated his intention to consider the bill early this year.

A common theme of these trade and political measures is that the United States is now more vulnerable to economic than military threats. The reintroduction of these bills reflects the commitment of some in Congress to counter perceived threats to U.S. economic security by acting more aggressively in trade relations and more cautiously toward foreign interests in this country. Many legislators appear prepared to continue their battle to ensure that the executive branch implements trade laws in a manner that fulfills congressional intentions and objectives.

Margo Grimm

Depressed U.S. Car Market Tests Japanese Makers

"A level playing field," Detroit's old trade catchphrase, has taken on a new meaning in the 1990s. The deepening slump in American car sales is forcing Japanese automotive makers with domestic assembly facilities to take a hard look at their U.S. production plans and often revamp them, something the Big Three had to do years ago. No longer can Honda Motor Co., Ltd., Toyota Motor Corp., Nissan Motor Co., Ltd., Mazda Motor Corp., Mitsubishi Motors Corp. and Fuji Heavy Industries, Ltd. (Subaru) count on selling as many cars as their U.S. plants can turn out (see Table 1). Not even cutbacks in shipments from Japan and incentives, the tactics used in the soft market of the late 1980s, necessarily will keep sales of transplant cars on the upswing.

Japanese motor vehicle manufacturers' first-quarter 1991 U.S. production schedules and recent announcements of additional cuts in U.S.-bound car exports highlight the new realities of the American car market, but the 1990 sales figures provided early warning that even the best-selling Japanese models would be

Table 1: U.S. Car Production (Commercial), 1988-90

(units)

	1988	1989	1990	Straight-Time Car Capacity
Honda of America Manufacturing, Inc. (Marysville, OH and and East Liberty, OH)	366,355	362,274	433,317	510,000
New United Motor Manufacturing Inc. (Fremont, CA)	128,430	192,471	204,513	240,000
Nissan Motor Manufacturing Corp. U.S.A. (Smyrna, TN)*	109,897	115,584	97,568	120,000
Mazda Motor Manufacturing (USA) Corp. (Flat Rock, MI)	163,289	216,501	181,108	240,000
Toyota Motor Manufacturing, U.S.A., Inc. (Georgetown, KY)	18,527	151,088	217,463	200,000
Diamond-Star Motors Corp. (Normal, IL)	0	92,777	151,052	240,000
Subaru-Isuzu Automotive Inc. (Lafayette, IN)**	0	5,361	35,115	60,000
Total Japanese-Affiliated Plants	786,498	1,134,020	1,320,136	1,610,000
Volkswagen of America Inc.	35,997	0	0	
General Motors Corp.	3,427,276	3,101,697	2,654,962	
Ford Motor Co.	1,806,802	1,678,068	1,377,351	
Chrysler Corp.	1,072,845	916,191	722,882	
Total U.S. Output	7,129,420	6,829,976	6,075,331	
Japanese Share	11.0%	16.6%	21.7%	

*Plant's total capacity is 240,000 units a year, divided about equally between cars and compact pickup trucks.

**Plant's total capacity is 120,000 units a year, divided about equally between cars and compact pickup trucks/sports-utility vehicles.

Source: Automotive News

a tougher sell in the coming months. Last year was the worst 12 months for U.S. car sales since 1983, when sales began to pick up after taking a beating during the 1980-82 recession. Only 9.3 million cars moved off dealers' lots in 1990, 4.9 percent fewer than in 1989 and 18.5 percent less than in the record 1986 sales year (see Table 2). Compared with the numbers for General Motors Corp., Ford Motor Co. and Chrysler Corp., sales of Japanese-badged cars held up remarkably well last year, rising 4.7 percent to nearly 2.6 million units. But all of this gain and then some reflected a 36.2 percent jump to nearly 1.1 million in sales of Japanese nameplates made in the United States; imported models

Table 2: U.S. Retail Car Sales, 1983-90

(units)

Manufacturer/Seller	1983	1984	1985	1986	1987	1988	1989	1990
Japanese Imports								
Toyota Motor Corp. (incl. Lexus)	542,877	513,820	577,181	601,939	562,274	584,284	464,551	430,668
Honda Motor Co., Ltd. (incl. Acura)	350,670	374,819	406,413	458,268	421,688	393,370	393,630	390,761
Nissan Motor Co., Ltd. (incl. Infiniti)	521,902	485,298	535,372	494,294	405,996	360,745	397,130	336,366
Mazda Motor Corp.	173,388	169,666	211,093	222,676	206,354	219,002	184,583	153,055
Mitsubishi Motors Corp.	32,755	39,104	49,734	49,436	67,954	70,075	79,751	99,630
Fuji Heavy Industries, Ltd. (Subaru)	156,840	157,385	174,100	179,100	175,864	155,944	136,112	92,729
Daihatsu Motor Co., Ltd.	0	0	0	0	0	11,460	15,111	10,630
Suzuki Motor Co., Ltd.	0	0	0	0	0	524	6,008	6,525
Isuzu Motors Ltd.	20,731	17,233	26,953	38,910	39,587	24,520	16,296	5,837
Isuzu Motors Ltd./General Motors Corp.	0	2,077	53,593	99,380	76,852	68,347	62,232	86,257
Mitsubishi Motors Corp./Chrysler Corp.	103,569	91,718	105,213	135,528	120,337	113,800	98,280	65,263
Suzuki Motor Co., Ltd./General Motors Corp.	0	10,927	31,267	60,983	60,359	48,088	53,272	42,488
Domestic Makes								
General Motors Corp.*	4,053,561	4,587,508	4,607,458	4,532,798	3,555,538	3,641,542	3,276,941	3,141,157
Ford Motor Co.**	1,571,321	1,979,317	2,070,392	2,066,507	2,019,783	2,205,636	2,041,808	1,845,895
Chrysler Corp.***	841,622	986,998	1,139,936	1,173,463	962,057	1,062,782	917,506	795,096
American Motors Corp.	193,351	190,255	123,449	72,848				
Volkswagen of America Inc.	85,045	73,838	77,535	73,912	61,064	24,939	0	0
Honda of America Manufacturing, Inc.	50,402	133,601	145,976	235,247	316,618	375,625	389,472	464,118
New United Motor Manufacturing Inc./ General Motors Corp.	0	0	35,594	170,507	134,956	96,868	89,710	109,631
New United Motor Manufacturing Inc./ Toyota Motor Sales USA Inc.	0	0	0	7,281	44,853	58,579	81,201	135,953
Nissan Motor Manufacturing Corp. U.S.A.	0	0	39,794	52,602	119,678	112,125	103,134	109,575
Mazda Motor Manufacturing (USA) Corp./ Mazda Motor of America, Inc.	0	0	0	0	1,671	31,331	41,584	72,657
Mazda Motor Manufacturing (USA) Corp./ Ford Motor Co.	0	0	0	0	0	77,763	133,650	103,062
Toyota Motor Manufacturing, U.S.A., Inc.	0	0	0	0	0	13,775	131,187	212,587
Diamond-Star Motors Corp./ Mitsubishi Motor Sales of America, Inc.	0	0	0	0	0	0	32,018	49,877
Diamond-Star Motors Corp./Chrysler Corp.	0	0	0	0	0	0	28,243	69,441
Subaru-Isuzu Automotive Inc./ Subaru of America, Inc.	0	0	0	0	0	0	0	15,818
Domestic Makes Built by Big Three	6,659,855	7,744,078	7,905,641	7,675,109	6,402,422	6,735,329	5,984,652	5,500,014
Domestic Makes Built by Japanese Affiliates	50,402	133,601	221,364	465,637	617,776	766,066	1,030,199	1,342,719
Total Japanese Imports	1,902,732	1,862,047	2,170,919	2,340,514	2,137,265	2,050,159	1,906,956	1,720,209
Total Imports	2,357,652	2,379,567	2,777,319	3,194,399	3,111,851	3,017,338	2,756,171	2,452,999
Total Domestic Makes	6,795,302	7,951,517	8,204,721	8,214,662	7,081,262	7,526,334	7,014,851	6,842,733
Total Market	9,152,954	10,331,084	10,982,040	11,409,061	10,193,113	10,543,672	9,771,022	9,295,732
Market Share of Japanese Imports	20.8%	18.0%	19.8%	20.5%	21.0%	19.4%	19.5%	18.5%
Market Share of Japanese Imports and Domestic Makes Built by Japanese Affiliates	21.3%	19.3%	21.8%	24.6%	27.0%	26.7%	30.1%	32.9%

*Starting in 1985 includes the Geo Nova/Prizm made by New United Motor Manufacturing Inc.
**Starting in 1988 includes the Ford Probe made by Mazda Motor Manufacturing (USA) Corp.
***Starting in 1989 includes the Plymouth Laser and the Eagle Talon and Summit made by Diamond-Star Motors Corp.

Source: Automotive News

were off 9.9 percent to 1.5 million in their fourth straight year of decline. Perhaps more telling, just three of Japan's nine car manufacturers managed to post sales increases here in 1990: Honda, the maker of the Accord -- the top-selling car for the second year in a row, Toyota and Mitsubishi Motors. And only MMC was able to boost sales of both domestically built cars and imported ones.

Even if U.S. industry analysts are right and sales of made-in-America Japanese-badged models drop this year, Japanese manufacturers still will take market share from the Big Three. That conclusion holds whether the gauge is sales of Japanese nameplates or sales of Japanese-made cars. Japanese nameplates picked up 1.5 percentage points of market share in 1990, winning 27.8 percent of what business there was, while the market share captured by Japanese-built cars (which includes vehicles sold by GM, Ford and Chrysler) jumped from 30.1 percent to 32.9 percent. Either way, Japanese suppliers moved into politically dangerous territory last year.

Any doubts were dispelled January 11 when United Auto Workers president Owen Bieber fired off a letter to International Trade and Industry Minister Eiichi Nakao calling for a cap on Japan's share of the U.S. car market well below 1990's figure. This proposal, endorsed by Chrysler chairman Lee Iacocca, came in response to the news that Tokyo had decided to extend the economically irrelevant 2.3 million-unit quota on car exports to the United States through March 1992. While the UAW mentioned no specific numbers publicly, Japanese press sources reported that the union used a figure of 1.3 million transplant and imported cars, the equivalent of a 14 percent market share. Executives of Japanese automotive companies dismissed this proposal out-of-hand, the same treatment they had given similar suggestions in the past. But with sales of Big Three-built cars in even more trouble than sales of Japanese models, these officials realize that the UAW and other supporters of U.S. auto industry protection are not going to wait until next year to revive the idea of an overall ceiling on Japanese car sales in the United States.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

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JAPAN'S ROLE IN MULTILATERAL FINANCIAL ORGANIZATIONS

Summary

Now that Japan has become the world's largest creditor, international society naturally expects Tokyo to play a major role in world economic and political affairs. Except for its substantial monetary contributions to various multilateral financial organizations, Japan so far has maintained a very low profile and has seemed reluctant to take any initiatives in the international political field. This is changing. Recent successful attempts by Tokyo to gain more voting power in such multilateral financial organizations as the World Bank, the International Monetary Fund and regional development banks point to a new Japanese attitude toward international policymaking.

While Japan's extensive financial commitments may continue at present levels, or even increase, the opportunities are abundant for a greater role in drafting policies as well as contributing expertise. Given Japan's emphasis on the role of the private sector in helping economies stabilize and develop, any new policy initiatives suggested by Tokyo for multilateral financial organizations might be expected to encourage private-sector input. As Tokyo seeks greater involvement in handling the Third World debt crisis and assisting in the liberalization of newly democratized economies, its political voice may begin to sound as a soloist instead of a member of the chorus.

Passivity, Pressure and Pocketbook Power

Japan's recent role in the Persian Gulf crisis illustrates Tokyo's typical position in international politics. Although the country has pledged about

$11 billion in assistance to the multilateral forces plus $2 billion in aid to frontline states in the Middle East, many in Washington have complained that Tokyo's response is inadequate. Some critics have said that Japan should contribute more in personnel rather than money to show its goodwill as an ally. Others say the pledged amount is nowhere near the commensurate value to Japan of preserving the status quo in the Middle East, on which Japan depends for nearly 70 percent of its oil imports (see JEI Report No. 4B, February 1, 1991). Tokyo's response often looks passive and gives an impression that the country will not take any initiatives without pressure from outside (see JEI Report No. 6A, February 15, 1991). But the Persian Gulf War, which the allies are fighting under a United Nation's Security Council decision in which Japan had no voice, underscores the frustration Tokyo occasionally feels when it is asked for money but not given a role in deciding whether the purpose of the expenditure meets its goals.

As policymakers in Tokyo weigh Japan's involvement in the Persian Gulf War along with public attitudes, their discussions are likely to address a theme that previously emerged in Tokyo's efforts to enlarge its voice in the decisionmaking process of multilateral financial organizations. This theme recognized that those who contribute heavily to an international financing group expect a commensurate share in the policymaking body of such a group. Tokyo's past experiences in achieving more political responsibility provide a study in how Japan has grown more international, letting its pocketbook lead the way.

Financial Support

Tokyo has tried to demonstrate its goodwill through various international forums, including the political and the economic summit meetings of the seven leading industrialized nations, the Organization for Economic Cooperation and Development, the International Monetary Fund and the World Bank. Especially since Japan began accumulating a large trade surplus, made more acute after the appreciation of the yen following the Plaza Accord in 1985, Tokyo has sought to recycle its capital to the Third World, which has suffered from a severe accumulation of debt.

One of the largest financial initiatives taken by this economically stronger Japan was a three-year $30 billion capital recycling plan announced in 1987 by then Prime Minister Yasuhiro Nakasone. Approximately 60 percent of the outlays between FY 1987 and FY 1989 was reserved specifically for contributions to multilateral organizations. Most of the remainder was assigned to cofinancing programs. The direct contributions included $3.6 billion for a special fund at the IMF, $2 billion for a special World Bank fund, $1.3 billion for the Asian Development Foundation (a window of the Asian Development Bank), a $2.6 billion subscription to the International Development Association (the World Bank's soft loan arm) and $8 billion for government subscriptions and private bond purchases for multilateral financial organizations.

An additional $9 billion was used in relation to the multilateral organizations' activities through the form of cofinancing loans. These were administered in conjunction with the Overseas Economic Cooperation Fund, the

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Export-Import Bank of Japan and private banks; they require that developing countries receive cofinancing from a multilateral financial organization, such as the IMF, the World Bank, the Asian Development Bank, the Inter-American Development Bank or the African Development Bank. The remaining $3.5 billion was provided through the Ex-Im Bank as untied bilateral loans (see JEI Report No. 20A, May 20, 1988). At the 1989 economic summit meeting in Paris Tokyo pledged another $35 billion to enlarge the recycling plan and extend it through FY 1991 (see JEI Report No. 28B, July 21, 1989).

Voting Power

As Japan increased the amount of assistance flowing to multilateral organizations, especially since 1987, so did its leaders boost their efforts to gain a greater political say in how these funds were spent. The voting share in most multilateral financial organizations is tied closely to the size of a country's contribution to the capital fund; when one country increases its share, another loses. More accurately, each member country possesses basic equal votes; additional votes are distributed to member countries proportionately to their shareholding in the capital fund. Not all donations, however, go into the capital fund on which voting shares are based. Nations also can contribute to so-called "special funds" or to cofinancing arrangements, which do not figure in the voting rights calculations. It is to these special funds that Japan has made significant contributions in recent years. Therefore, Tokyo wanted its voting power to reflect its substantially increased commitments.

The politically touchy call for a greater voting share requires concessions by other members, especially those that would lose their status. It also often has accompanied an increase in the capital of the IMF and the World Bank funds, which posed a problem for both organizations' biggest contributor, the United States, as it began suffering from budget deficits in the 1980s. An increase in capitalization means Washington has to contribute the largest portion of the increase if it wants to maintain its present voting status, which it has fought to do. Moreover, as the single country in both the World Bank and the IMF with veto power, the United States had tied realignment of voting shares to its demand to retain that veto power.

When the latest rearrangement of shares in the World Bank occurred between 1984 and 1986, Japan's share was raised from 5 percent to 6.5 percent, boosting its ranking from fourth place to second place. Washington agreed to a reduction in its shareholding to 18 percent from 20 percent in exchange for an amendment of the bank's rules enabling the United States to maintain its veto. More accurately, the World Bank decided the increase of capital in 1984 and the rearrangement was accomplished at the end of 1986. Since Japan was one of the first to pay its proposed portion of capital, Tokyo technically has occupied the number-two seat since 1985 (see JEI Report No. 20A, May 20, 1988).

In the realignment sought by Japan in the IMF in particular, the largest European contributors viewed Tokyo's request to enlarge its shareholding from a different position than that of the United States. Their caution stemmed from a concern about their relative ranking as contributors rather than the proportional share of their capital contribution. Since the IMF is one of the most prestigious organizations in international finance, Britain, Germany and France did not want their ranking to fall even though their voting power would remain almost the same.

Major industrialized countries previously had declared their intentions of keeping their status quo in the IMF. Although they had welcomed Prime Minister Nakasone's ambitious $30 billion capital recycling plan, they had added the condition that the initiative not influence Japan's voting power in the IMF, where it held the number-five position at that time despite 20 years of growing contributions. To reconcile the seemingly inconsistent political demands with the arithmetic of increasing Japanese support, Tokyo had been assigning its additional financial contributions to either "special funds" or cofinancing programs since neither approach required rearranging the capital shares.

Not satisfied with this situation, Tokyo continued to call for upgrading its voting status in the IMF. At first Japan tried to convince other member countries of the necessity of a capital increase to respond effectively to the Third World debt crisis. Former Minister of Finance Kiichi Miyazawa proposed at the 1988 IMF-World Bank general assembly a new debt relief plan, which stressed further involvement by the IMF in solving the financial crisis in developing countries. Mr. Miyazawa suggested that the IMF back government bonds that would be issued by recipient countries as security for private banks, which then would accept a reduction of their debt holdings. Although some developing countries showed an interest in Tokyo's proposal, both the United States and European nations responded coolly or ignored the proposal.

Washington, which had been somewhat ambivalent about the IMF being more involved in Third World debt relief, eased its previous reluctance after the Bush administration took office. In 1989 Washington unveiled a debt relief proposal sketched out by Treasury Secretary Nicholas Brady (see JEI Report No. 15B, April 14, 1989). Since the Brady Plan in many ways resembled a revised version of the Miyazawa Plan, Tokyo quickly stood behind the initiative and promised to provide over $10 billion in loans that would parallel those made by the World Bank and the IMF to countries that agreed to negotiate under the new debt relief program. When Mexico and the Philippines were qualified as the first and the second countries where the Brady Plan was applied, the Ex-Im Bank agreed to provide a total of $2.7 billion to these two countries. Some analysts argue that Tokyo's substantial support for the Brady Plan was one way it hoped to win Washington's backing for an increase in Tokyo's IMF voting power. When Finance Minister Ryutaro Hashimoto addressed the IMF's annual meeting in 1989 and sought an increased role for Tokyo at the IMF, he stressed that Japan was the only individual contributor to the debt reduction program for Mexico and the Philippines, two countries in which the United States has had vital interests.

Although Washington supported Tokyo's demand for upgrading its voting power at the 1989 IMF meeting, European countries prevented Tokyo's quest at that time. Germany was also pushing for the number-two ranking if a rearrangement were to take place. France wanted to maintain at least the same ranking, or the number-four position, under any new arrangement. Britain, which had maintained the second-largest voting power since the IMF's establishment, strongly opposed Tokyo's quest, fearing London's new position would be fifth place. Under such opposition Tokyo finally gave up at the 1989 meeting.

But international developments leaned in favor of Tokyo's long-standing goal. Dramatic changes pushed Eastern Europe toward market-based economies and more democratic governments and raised calls among Western nations for substantial financial support to help these countries' progress. Western European countries with keen interests in their Eastern Bloc neighbors saw an urgent need to enlarge the IMF's financial resources, which would allow some adjustment in shareholdings. Japan, the United States and Europe finally agreed in 1990 to rearrange IMF shareholdings (see Table 1). Although the new arrangement will not be finalized until every member subscribes its proposed portion of the capital, Tokyo will share the number-two seat with Germany while France and Britain both will occupy the number-four position. Although the United States kept its same voting share, Britain lost while the others gained.

Table 1: Changes in IMF Shareholding and Voting Power, Ninth Capital Increase

Until September 1990			After September 1990		
	Shareholding	Voting Power		Shareholding	Voting Power
United States	19.88%	19.10%	United States	19.62%	19.10%
Great Britain	6.87	6.62	Japan	6.10	5.95
West Germany	6.00	5.78	West Germany	6.10	5.95
France	4.97	4.80	Great Britain	5.48	5.35
Japan	4.69	4.52	France	5.48	5.35

Source: International Monetary Fund

Now that its position at the IMF has been readjusted, Japan can claim at least the number-two ranking in all international financial organizations. It has that rank in the affiliated organizations of the World Bank, such as the International Development Association -- the provider of loans on noncommercial terms to low-income developing countries; the International Financial Corp. -- an equity investor in private corporations in Third World countries; and the Multilateral Investment Guarantee Agency -- an investment insurance body endorsing private investment in developing countries (see Table 2).

Holding the second-largest voting power in these organizations, though, has not boosted Japan's low profile in substantial decisionmaking. Some analysts argue that Tokyo so far has conducted itself as a good boy, seconding Washington's initiatives to get support in Japan's bid to win the number-two ranking in the principal international organizations. Whether Tokyo will continue its present attitude or whether it will play a more active, independent role remains to be seen. One indication of its prospects may lie in a recent disagreement between Tokyo and Washington over management of the Asian Development Bank. The dispute over a secondary financing initiative may hint that Tokyo is willing to go solo in certain circumstances.

Asian Development Bank

Japan, the most advanced industrial country in Asia, maintains vital trade and economic relations with the region. In addition, Japan is the largest provider of capital in this part of the world, both in terms of foreign aid and private-sector loans and investment. Since the 1966 establishment of the Asian Development Bank in Manila, Japan has played the predominant role; its 16.4 percent share of the total capital is equivalent to that of the United States

Table 2: IMF and World Bank Group, 1990

	International Monetary Fund	World Bank	International Development Association	International Finance Corp.	Multilateral Investment Guarantee Agency
Year Established	1945	1945	1960	1956	1988
Year of Japan's Entry	1952	1952	1960	1956	1983
Member Countries	154	154	138	138	63
Total Capital (billions)	$183*	$171	$67	$1.3	$1.0
Shareholders					
Japan	6.10%	6.7%	16.5%	6.3%	5.1%
United States	19.62	18.9	25.9	25.4	20.5
West Germany	6.10	5.2	11.4	5.8	5.1
Great Britain	5.48	5.0	8.6	5.4	4.9
France	5.48	5.0	6.4	5.4	5.1
Canada	3.20	3.2	5.0	3.7	3.0
Total Employees	1,862	5,776		604	38
Japanese Employees	25	71		5	3
Japanese Share	1.3%	1.2%		0.8%	7.9%

*Proposed equivalent of 135 billion Special Drawing Rights at 1990's average exchange rate of 1 SDR=$1.35675.

Source: Ministry of Finance

but its ranking is that of number-one. Ministry of Finance officials traditionally have been appointed to head the bank. Currently 64 Japanese officials comprise 3.8 percent of the total staff of 1,670.

Whenever an increase in the ADB's capital has taken place, Tokyo and Washington have been expected to provide the same subscription to maintain parity in voting power. Generally, Japan has been more positive about raising capital, while the United States has acted passively. Since Washington has been unwilling to yield the leading position to Tokyo and usually is reluctant to accept proposals for additional capital, increases at ADB usually take time. To satisfy urgent financial needs among the bank's clients and to avoid influencing the voting share, Tokyo has arranged to contribute to a special fund, called the Asian Development Foundation. While the ADB's capital principally is used for commercial loans to developing countries in the region, the Asian Development Fund is reserved for loans to low-income Asian countries on concessional terms. The size of the ADF amounts to about $10 billion, which is almost half the ADB's capital. Of the total contribution to the ADF, Japan provides 37 percent while the United States chips in only 18 percent.

A plan to establish an Asian Finance and Investment Corp. in 1989 led to a reported dispute between Japan and other major industrialized countries. The proposed organization was to be similar to the World Bank's International Finance Corp., offering equity investment and lending to private companies in the region. While Japan and most Asian countries voiced strong support for the proposal, the United States and European members expressed concern about whether such an organization was needed. They also questioned Japan's proposed predominance since various reports suggested Tokyo had promised to provide about 40 percent of the total capital and nominate the head of the organization (see JEI Report No. 23A, June 16, 1989). When Tokyo agreed to limit its share to about 30 percent, the AFIC was born (see JEI Report No. 31B, August 11, 1989). Jiro Yamana, who had been deputy president of Daiwa Securities Co., Ltd., was appointed as AFIC's first president. This has been one of the exceptional cases in which Japan has taken the initiative in the establishment and operation of an international organization.

Other Regional Development Banks

In other regional financial organizations Japan's presence has been less visible than its work in the Asian Development Bank. Quite recently, however, Japan has taken a more active financial interest in these other organizations. In the case of the African Development Bank, established in 1964, Japan is the second-largest subscriber, providing 5.1 percent of the total capital. This is close to the 6 percent share contributed by the United States, even though Japan joined the bank only eight years ago (see Table 3). Moreover, Tokyo is the largest contributor to the African Development Fund, which functions similarly to the Asian Development Fund; here, Japan provides 14 percent of the resources and the United States contributes 13 percent. In line with Tokyo's capital recycling plan, the Overseas Economic Cooperation Fund, the soft loan arm of Japan's foreign aid program, has organized cofinancing projects with the bank.

Even in the Inter-American Development Bank, where Washington's influence predominates, Tokyo contributes the third-largest amount of capital; its 1.1 percent share is the largest from outside of the region. In addition, the Ex-Im Bank has organized cofinancing programs with the IADB in Chile, Colombia

Table 3: Regional Development Banks, 1990

	Asian Development Bank	Asian Development Fund	Inter-American Development Bank	Inter-American Development Fund	African Development Bank	African Development Fund	European Bank for Reconstruction and Development
Year Established	1966	1974	1959	1959	1964	1973	1991*
Year of Japan's Entry	1966	1974	1976	1976	1983	1973	1991*
Member Countries	49	22	44	44	75	26	40*
Total Capital (billions)	$20.2	$10.2	$60.9	$8.6	$21.2	$7.2	$11.0**
Shareholders							
Japan	16.4%	37.0%	1.1%	2.1%	5.1%	14.0%	8.5%
United States	16.4	18.4	34.7	54.8	6.0	13.4	10.0
West Germany	4.5	6.6	1.0	2.0	3.8	9.2	8.5
Great Britain	2.1	4.6	1.0	1.9	1.5	3.7	8.5
France	2.4	4.5	1.0	1.9	3.4	7.7	8.5
Canada	5.5	8.2	4.4	3.0	3.5	9.9	3.4
Total Employees	1,670		1,694		1,030		n.a.
Japanese Employees	64		3		0		n.a.
Japanese Share	3.8%		0.1%		0.0%		n.a.

*Projected.
**Equivalent of 10 billion European Currency Units at 1989's average exchange rate of 1 ECU=$1.10175.

Source: Ministry of Finance

and Venezuela. Most of the member countries welcome Tokyo's further involvement, and the next annual meeting is scheduled for April in Nagoya. This will be the first annual assembly held by the bank away from the North or South American continents.

Japan also has committed funds to the newly established European Bank for Reconstruction and Development. The bank will begin operations this year in London to facilitate financial support and encourage democratization in Eastern Europe and the Soviet Union. Tokyo has agreed to contribute 8.5 percent of the bank's capital, second only to the United States. Germany, Britain and France each also will give an 8.5 share. European members no longer appear concerned about Tokyo's presence as the second-largest voting power since Japan is expected to be able to contribute substantial financial support in areas where Western European countries hold vital interests. Tokyo, however, is questioning the wisdom of rapidly increasing financial support to the region and especially to the Soviet Union. The Soviet issue is to be discussed at the formal London meeting establishing the bank. Japan is expected to raise its concerns then and may offer restrictions that could influence the operation of the bank.

Contribution of Personnel

Compared to its financial outlays, Japan's contribution in personnel is nearly invisible. There are few Japanese staff members in the various multilateral financial organizations and few appointees to high-ranking posts. Only 1.3 percent of the IMF staff, for example, is Japanese. At the World Bank Japanese personnel make up barely 1.2 percent of the total. Many of the Japanese employees in multilateral institutions hold short-term appointments, especially those occupying high-ranking positions or those sent by the Japanese government or public organizations. Few Japanese personnel apply directly to international organizations for long-term jobs.

Various reasons are given for the lack of Japanese staff in these multilateral bodies. The appreciation of the yen between 1985 and 1988 and the associated fall of the dollar made salaries paid in dollars by the multilateral institutions less attractive to Japanese workers than they had seemed five years earlier, although even then Japanese workers showed little interest in these posts. Language also has served as a barrier as has the requirement by many international institutions that staff members have at least a master's degree.

These reasons, however, do not fully explain the current situation. Many Japanese companies now encourage their employees to get an advanced education at business schools in the United States or Europe. And, as more Japanese government officials gain overseas diplomatic expertise, multilateral institutions offer opportunities for those who face a narrowing seniority ladder. Even lack of income incentives can be overcome if employers provide supplemental pay to employees sent to multilateral organizations. Both the government and the private sector in Japan have an increasing number of staff who would be qualified to serve in an international institution. However, bureaucratic personnel issues (such as job rotations) sometimes complicate the government's ability to assign qualified staff. In the corporate sector it is difficult to find among the eligible Japanese a sufficient number with an interest in working as a staff member in a multilateral institution. Since the career path of Japanese workers means that those who leave a company even temporarily end up delaying their promotion schedule, workers often hesitate to voluntarily apply for jobs in multilateral organizations. From the employers' point of view, they usually are reluctant to send highly educated employees outside the company unless they have a particular goal to achieve by doing so (see JEI Report No. 43A, November 9, 1990). Moreover, the strong societal push to sign on with a company or join the government right out of school to take advantage of the seniority system means that few individual Japanese will free-lance at these organizations, especially since they would not have government or corporate support in bids for advancement.

Another factor may be that few Japanese have contact with multilateral financial organizations. Except for the Ministry of Finance, most Japanese ministries rarely deal with the IMF or the World Bank. Only a small number of Japanese companies so far have close business relations with international institutions through cofinancing or coinvestment activities. If Tokyo intends to encourage more Japanese from the public and the private sectors to work for international entities, higher visibility of these organizations is important. One way for Tokyo to draw attention is to emphasize that it has an agenda that is distinct from Washington or other world capitals. Active campaigns for the appointment of high-ranking officials is another way, such appointments presumably would serve as role models and help to legitimize and popularize international careers for other Japanese professionals. If the candidates are found in the private sector, this has an incremental effect of improving the chance that businesses interested in increasing their relations with the organizations might provide personnel.

The 1988 appointment of Yoshio Terasawa, vice president of Nomura Securities Co., Ltd., as the executive vice president of the Multilateral Investment Guarantee Agency and the 1989 appointment of Mr. Yamana of Daiwa Securities as the president of the Asian Finance Investment Corp. were historic in that these veterans of more than 25 years in the securities industry became the first and the second Japanese from the private sector to be named to high office in international financial organizations. When Mr. Terasawa's nomination was announced, almost every nationwide daily made him their "newsmaker of the day." The appointments, in some part, resulted from strong lobbying by the Japanese government. It also suggested that multilateral financial institutions, which recently have focused on the introduction of market mechanisms in the Third World and the newly democratized economies of Eastern Europe, expect more Japanese businessmen to contribute in their field of expertise to the operations of such institutions. Since many Japanese government officials and businessmen retire at a relatively early age -- around 60 -- and seek post-retirement positions elsewhere, there is an abundant crop of talent available for multilateral organizations to harvest. Some analysts even anticipate the possibility that a Japanese might be appointed as president of the IMF or the World Bank in the near future, although the former post generally has been held by a European and the latter by an American.

Private Sector's Contributions to Multilateral Organizations

Some observers suggest that the appointments of Messrs. Terasawa and Yamana imply that multilateral organizations may be able to expand their ties with the Japanese private sector in hopes of tapping its financial capacity, technology and management know-how. To encourage the economic reforms taking place in Third World countries and Eastern Europe, the IMF, the World Bank and regional development banks all have come to realize the importance of private investment in the recipient countries. They have become more concerned about facilitating the private sector's manufacturing activities in severely indebted countries rather than relying on loans -- both from multilateral groups and private banks -- to solve fundamental problems associated with debt accumulation.

Unlike lending from financial institutions, direct investment does not increase the official debt burden of recipient countries. New joint ventures have the potential to expand employment and facilitate technology transfers, which, in turn, strengthen export competitiveness so that these countries can earn hard currency that can be used for debt repayment. Foreign investment also helps introduce market mechanisms, much sought by Eastern European economies as they implement economic and social reforms. Private companies, however, often hesitate to invest in countries where political and economic risks are high or where they do not have much business information. Multilateral organizations thus can play a coordinating role between investors and host countries.

Private companies can access economic information about host countries through international agencies and can convey their demands to the host country's government by way of the multilateral institutions. The World Bank and the IMF monitor the economic conditions of recipient countries and sometimes provide recommendations necessary for improving business circumstances in the countries. The World Bank and its affiliated organizations often host seminars both in developing and industrialized countries to provide useful information to private investors and the host country's government. Regional development banks also have a function similar to that of the World Bank and its sister organizations. The International Finance Corp. facilitates joint ventures between foreign investors and host countries' enterprises by participating itself as a shareholder in an investment and by providing loans to these joint ventures. The simple presence of the international entity can secure the investment. For example, when the Brazilian government in 1987 announced a rescheduling of its dept repayment, IFC-associated projects were exempted from the rescheduling. MIGA, established in 1988, underwrites investment insurance for foreign investors in developing countries. Since MIGA's insurance is accompanied by an accord with the host country's government, insurance claims stemming from political upheavals -- like expropriation -- are expected to rarely occur.

Japanese companies, until recently, have tended to rely on their own resources and to turn to Tokyo or the Ex-Im Bank for additional financial support or to underwrite trade insurance rather than seeking help from international organizations. Moreover, Japanese firms wanting to get help from the World Bank and its affiliated organizations often are obliged to visit headquarters in Washington to negotiate on terms. A shortage of Japanese staff in these organizations also reduces the interest of Japanese investors.

Now, however, international financial organizations are looking to Japanese companies for resources. In the past three or four years the World Bank, the IFC and MIGA have held a series of seminars in Japan to introduce their activities to companies there. Keidanren (Japan Federation of Economic Organizations) has reciprocated by sending two missions, consisting of chief executives of major Japanese companies, to Washington in the last three years to exchange views on further cooperation with high-ranking officials of the international institutions. Further spelling out its interest in Japanese economic participation, the IFC opened a branch office in Tokyo in 1987 to maintain better contacts with Japanese investors. Of the 185 Japanese companies that have had overseas joint ventures associated with the IFC over the past 25 years, 63 ventures were launched after the 1987 establishment of an IFC Tokyo office. Recent joint ventures include six projects in Hungary where Japanese companies so far have invested very little. Such moves are expected to deepen business relations between Japan's private sector and multilateral financial organizations. As Japan's private sector expands its business relations with these institutions, Tokyo's role in decisionmaking also is expected to become more influential. Just as Tokyo considers private-sector support an important element in the bilateral economic assistance it provides, so does that backup appear important for Japan's role in multilateral institutions.

Conclusion

Japan's recent quest to enlarge its economic and political presence in international financial organizations illustrates that Tokyo is serious about making an international contribution and accepting added global responsibilities, at least in the financial arena. After having achieved its long-standing goal of the number-two ranking in the principal multilateral financial organizations, Tokyo can be expected to take more of a lead in decisionmaking as well as to continue its support through financing and personnel. By taking advantage of financial and technological resources in Japan's private sector, Tokyo may provide innovation in the policies of the multilateral organizations. Lessons learned at the helm of the Asian Development Bank suggest that Tokyo can take the lead in important decisionmaking even if it does not always have the wholehearted consensus of other major industrialized countries.

Secretary of State James Baker recently suggested a plan for establishing a Middle East Reconstruction Bank to cope with the post-gulf war situation. Former Finance Minister Miyazawa reportedly has shown keen interest in the plan and has implied that Tokyo should take a lead in the proposed organization, providing at least $10 billion for the next decade. Mr. Miyazawa's response to Washington's initiative shows that Tokyo is willing to play a more active role in world economic and political affairs in fields that reflect its special strengths and accumulating experience.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

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Japan's Current Account Drops Sharply In 1990

What if the Treasury Department had a bond auction and nobody -- or at least the much sought-after Japanese investors -- didn't come? While much of Wall Street and official Washington pondered that question in 1990, Japan's current account statistics were providing a partial answer. Last year Japan's current account surplus declined 37.4 percent from 1989's total (see Table 1). As a result of the double-entry nature of balance of payments bookkeeping, the current account also is the broadest measure of net capital flows. That suggests that Japan's net overseas investment declined a corresponding amount in 1990.

To the extent that Japanese firms sell more abroad than they buy, the difference is equivalent to the sum of net short- and long-term public and private investment in overseas markets. Table 2 offers the options available for a long-term private investor. The decline in long-term investment exceeded the drop in the current account surplus in 1990. For example, purchases of foreign bonds -- the focus of the Treasury auctions -- dropped to $29 billion, less than a third their 1989 level. Since bond prices were fairly stable last year in the United States, the impact of the Japanese pullback apparently was moderate at best. In short, the hypothetical question about the Treasury auctions has an answer already: Japanese investors are not necessary to sustain the market.

The portion of Table 2 detailing capital inflows shows the effects of the Tokyo stock market turmoil throughout 1990. As prices plummeted foreign investors headed for the exits, withdrawing a whopping $13.3 billion from the

Table 1: Japan's Balance of Payments

(in millions of dollars, IMF value basis)

	1986	1987	1988	1989	1990*
Current Account	$85,845	$87,015	$79,631	$57,157	$35,792
Trade Balance	92,827	96,386	95,012	76,917	63,856
Exports (f.o.b.)	205,591	224,605	259,765	269,570	280,177
Imports (f.o.b.)	112,764	128,219	164,753	192,653	216,321
Services	-4,932	-5,702	-11,263	-15,526	-22,587
Transfers	-2,050	-3,669	-4,118	-4,234	-5,477
Long-Term Capital	-131,461	-136,532	-130,930	-89,246	-43,455
Basic Balance	-45,616	-49,517	-51,299	-32,089	-7,663
Short-Term Capital	-1,609	23,865	19,521	20,811	21,367
Errors and Omissions	2,458	-3,893	2,796	-22,008	-20,938
Overall Balance	-44,767	-29,545	-28,982	-33,286	-7,234

*Preliminary.

Source: Bank of Japan

Table 2: Net Long-Term Capital Flows

(in millions of dollars)

	1989			1990*		
	Outflows	Inflows	Net	Outflows	Inflows	Net
Direct Investment	$-44,130	$-1,054	$-45,184	$-47,941	$1,750	$-46,191
Trade Credits	-4,002	-9	-4,011	744	-2	742
Loans	-22,495	17,813	-4,682	-22,190	39,112	16,922
Securities	-113,178	85,144	-28,034	-39,681	34,653	-5,028
Stocks	-17,887	6,998	-10,889	-6,256	-13,276	-19,532
Bonds	-94,083	2,400	-91,683	-28,961	16,991	-11,970
Yen-Denominated Bonds Issued in Japan	-1,208	n.a.	-1,208	-4,464	n.a.	-4,464
External Bonds**	n.a.	75,746	75,746	n.a.	30,938	30,938
Other	-8,313	978	-7,335	-11,572	1,672	-9,900
Total	-192,118	102,872	-89,246	-120,640	77,185	-43,455

Note: A negative sign indicates a capital outflow.

*Preliminary.
**Bonds issued outside of Japan by Japanese institutions.

Source: Bank of Japan

market. The decline in securities prices corresponded to a rise in the yields on bonds, which overseas buyers snapped up. Finally, sales of external bonds, which often are equity-linked instruments sold by Japanese companies in Europe, dropped dramatically as the attractiveness of the equity component evaporated in the minds of foreign investors.

On balance, inbound and outbound long-term capital flows both declined from 1989 levels and, although the inbound flow dropped less -- by $25.7 billion -- it somewhat cushioned the blow of the lower outflow. These numbers hint at a reason why U.S. financial markets hardly noticed the relative inactivity of Japanese investors. Funds are largely interchangeable; the pullout of foreign participants from Japan's stock market was a factor in enabling American and European investors to replace Japanese participants that were restricting their foreign activity.

Also meeting the apparent worldwide need for capital was another substitute for securities purchases, Japanese direct investment. These flows -- which suggest much more active involvement and long-term commitment than investments in stocks and bonds -- continued to increase in 1990. At $47.9 billion direct investment exceeded the balance of securities purchases for the first time since Japanese overseas investment became substantial in the early 1980s.

As noted above, although the decline in outbound securities purchases was offset partially by a decline in inbound flows and an increase in direct investment abroad, Japan's net capital outflow -- as measured by the current account surplus -- still declined. The shrinkage was virtually across the board, led by a reduction in the trade surplus. The services deficit widened, indicating still-surging tourism. The transfers account showed a larger net outbound flow partly as a result of payment of the first installments on the $4 billion Tokyo had pledged as of the end of 1990 to the Persian Gulf multilateral forces and Middle East nations adversely affected by the economic sanctions against Iraq and the gulf conflict. If Tokyo is able to fulfill its early 1991 pledge of an additional $9 billion, the current account surplus will get a significant downward nudge this year.

The probable slowdown in economic growth this year in both Japan and its leading market, the United States, will reduce both Japanese imports and exports compared to the levels they otherwise would reach. On balance, most experts expect relatively little change in the current account in 1991. If that proves true, Japan's external imbalance, which declined from 4.2 percent of gross national product in 1986 to an estimated 1.2 percent in 1990, could diminish further. A roughly constant surplus also would imply little change in Japan's net flow of funds to world capital markets. One way or another, Treasury will get its share; it need not worry about holding an auction to which nobody comes.

Douglas Ostrom

Kaifu Concedes To Opposition Demands On Gulf Aid Funding

Following weeks of often-heated debate with the political opposition and behind-the-scenes dealmaking, Prime Minister Toshiki Kaifu appears finally to

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NO. 9A

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POLLUTION CONTROL: CAN PAST LESSONS BE RECYCLED?

Summary

Japan's approach to pollution control contains some surprising anomalies. In a nation renowned for being nonlitigious, the court system initially played a dominant role in helping victims of pollution. And, while industry typically wears a black hat in most countries in terms of environmental degradation, corporate-government cooperation in Japan has been effective in responding to some pollution problems that have relied on a technical component but less so for others.

As Japan dons the accoutrements of advanced industrialization, its populace is shedding some of its conservatism in the use of natural resources. This may complicate the application of the lessons learned from coping with past air, land and water pollution problems. However, growing environmental awareness, technological breakthroughs and pressure to improve pollution abatement types of public infrastructure may provide the necessary stimulus.

Compensation Law Establishes Precedent

The Pieta-like picture of a mother bathing the wasted body of a family member drew worldwide sympathies in the 1970s and cast in infamy the corporation accused of dumping methyl mercury into the sea near Minamata, the name that would be linked to the mercury poisoning disease. Although Chisso Corp. tried vainly to deny its complicity as well as to threaten victims into silence, sufferers of Minamata disease eventually had their day in court. That day, however, was not vindicated by a judicial decision until 1973, more than

15 years after the disease first was defined. By then legislation passed by the 1970 "Pollution Diet" to strengthen earlier laws had begun to take effect, decreasing air and water contamination.

The Minamata court case was one of four in the early 1970s that helped shape the pollution-related Health Damage Compensation Law, which has been described as a law that was "created as a quicker and more efficient substitute for litigation, similar, for example, to the no-fault automobile accident insurance systems [in the United States]. . . ."[1] The other court decisions that helped shape the 1973 compensation law included similar mercury poisonings in the Niigata area, a cadmium-related contamination that led to the descriptively named "Itai-itai" or "Ouch, ouch" disease and a dispute in which 12 sufferers of asthma blamed six firms in the Yokkaichi area of Mie prefecture for contributing to air pollution that caused their respiratory problems.

The 1973 compensation law, which strengthened a 1969 measure, added weight to the enforcement of a tough air pollution law passed in 1968 and a less stringent water pollution law, which has been reinforced at frequent intervals since the original law was passed in 1958 to control effluents and improve water quality. Although it was revised in 1988, the 1973 compensation law originally allowed compensation to two categories of pollution-related victims: those living in Class 1 areas, in which the population was found to have above-average rates of respiratory problems, and those in Class 2 areas, which were connected to one of three specific diseases: mercury poisoning such as that found in Kumamoto and Niigata prefectures; cadmium poisoning, including, for example, that linked with Itai-itai disease in Toyama prefecture; and arsenic poisoning, tied to pollution in Miyazaki and Shimane prefectures.

Respiratory sufferers living in or commuting to an area ranked Class 1 for air pollution could receive compensation from a fund created from levies against area firms that polluted from stationary sources. These levies made up 80 percent of the fund, while a tax on motor vehicles supplied the remaining 20 percent in recognition of emissions from that source. This aspect of the law stemmed primarily from the Yokkaichi court case. Based on initial court rulings, those suffering from mercury poisoning were to work out compensation schemes directly with Chisso and Showa Denko K.K., the company found culpable in the Niigata poisonings. A public corporation continues to collect and administer the compensation monies for pollution victims who have been certified as eligible for compensation by panels that include medical experts.

Problems with the Law - Emotion may have had a greater hand than scientific evidence in helping win passage of the 1973 compensation legislation. But the lack of a solid scientific connection between respiratory problems in certain areas and specific emissions has been cited as one of the reasons that the

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[1] Bruce Aronson, "Legal and Policy Issues in the Japanese Compensation Law" in Tsukasa Namekata and Charles du V Florey (eds.), Health Effects of Air Pollution and the Japanese Compensation Law (Columbus, Ohio: Battelle Press, 1987), p. 146.

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Class 1 designation was dropped from the compensation law in March 1988. Although all those who formerly received compensation under the Class 1 section of the law continue to benefit, no new cases are being recognized.

In criticizing the scientific basis of the 1973 law epidemiologist Tsukasa Namekata noted at a 1984 workshop on issues in air pollution, "Current air pollution levels in both Class 1 and non-Class 1 regions [in Japan] are so low that, using epidemiologic techniques currently available, no effects can be detected although they might exist."[2] The Battelle Memorial Institute scientist criticized the studies used to determine if there were an above-average number of persons with pollution-related respiratory ailments in the area; among the failures, he said, was not taking into account whether surveyed households also contained smokers. Moreover, even if a Class 1 area's air pollution contributed to respiratory distress, the law did not allow compensation for those who suffered complications from associated illnesses, such as heart disease, Mr. Namekata noted.[3] He also pointed to the lopsided application of the law. Only 2.3 percent of the recipients reviewed in a December 1983 report by the Environment Agency suffered from acute poisoning diseases; the remaining beneficiaries all had respiratory illnesses.

Another controversy over the 1973 compensation law has developed because the government has certified less than one-fourth of those who have applied for compensation based on claims that they suffer from Minamata disease. By the end of last September 12,929 persons had applied to the government to be certified as official victims of mercury poisoning; however, only 2,925 had been declared eligible for the compensation of Y24 million ($177,800 at Y135=$1.00). Late last year the Environment Agency, which has a separate compensation fund for those physically impaired by pollution, included about Y188 million ($1.4 million) in its FY 1991 budget request to cover the health-care costs of those not officially determined to be Minamata victims.

Since FY 1974 the agency has helped with medical expenses under the auspices of medical research for those applicants whose certification has not yet been approved. Additional help has been made available since June 1986 to those rejected for certification provided they exhibit symptoms of Minamata disease. An indication of the continuing sensitivity of the issue came from the linkage in the Japanese press of the December suicide of an Environment Agency official to the pressures he faced from dealing with those who claimed compensation for Minamata disease and the government's October 1990 decision to reject court recommendations that these claims be settled out of court.[4]

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[2] Tsukasa Namekata, "Epidemiological Issues on Air Pollution in the Japanese Pollution-Related Health Damage Compensation Law" in Tsukasa Namekata and Charles du V Florey (eds.), Health Effects of Air Pollution and the Japanese Compensation Law (Columbus, Ohio: Battelle Press, 1987), p. 64.

[3] Telephone conversation with Tsukasa Namekata, research scientist at Battelle Memorial Institute's Human Affairs Research Center, Seattle, Washington, February 26, 1991.

[4] Vibeke Laroi, "Official's suicide is called a Minamata tragedy: Legal wrangle blamed," Japan Times, January 5, 1991, p. 2.

Even though Class 1 areas no longer are designated, the financing mechanism for the compensation fund remains intact; the portion previously tied to air pollution now supplies 80 percent of a Y50 billion ($370.4 million) fund to which the central government and companies associated with air pollution prevention contribute the remaining 20 percent. Projects that the Environment Agency singled out for receiving benefits from the fund in fiscal 1988 included asthma treatment and prevention assistance, promotion of battery-operated or methanol-fueled vehicles and increased planting of trees and construction of swimming pools.

A Mixed Legacy - Although now altered, the compensation law helped focus attention on pollution and the responsibility of firms to compensate victims whose health has been compromised by industrial activities. While Japanese firms are known to pay compensation to accident victims -- as in the case of airline crashes -- without the necessity of court cases, the compensation law was considered unique for the ease with which respiratory sufferers, particularly, could file claims and the scope of coverage, which included not just medical bills but loss of earning capacity as well.[5]

Were an individual or group to take compensation claims to court another law still benefits plaintiffs with pollution-related health complaints; it provides that negligence need not be proved, a more lenient standard than most tort law in Japan. In practice, though, the legal system still poses hurdles for those seeking compensation for environmental damages, as evidenced by the difficulties faced by Minamata sufferers. Moreover, with the cancellation of Class 1 designation for air pollution areas, all Japanese pollution cases fall back into the ranks of those that require "fault-based" litigation.

Even though companies face public censure for causing health problems and a levy on their pollution under the compensation statute, the inherent anti-industrial bias of this legislation appears to have been limited, judging by the response of local and central governments. The Environment Agency and the Kumamoto prefectural government, for example, have extended support to Chisso to help stabilize the region's economy. In addition, the central government urged financial institutions to support the company, while local officials agreed to allow the proceeds of special prefectural bond issues to be loaned to Chisso.

Monitoring and Cooperation a Key to Success

Fundamentally important to determining polluting culprits, particularly for air pollution, is Japan's monitoring system, where a cooperative approach between government and business is evident in the regulatory process. Throughout Japan large companies telemeter a constant flow of data from smokestack monitors to prefectural or municipal monitoring stations. Smaller companies are checked by areawide monitoring stations. If a certain plant or a region threatens to create an environmental emergency, government officials call plant operators and seek a reduction in emissions, either through a different fuel blend, a cutback in production or other alternatives. Periodic cross-checks of input-output data and monitored readings help make sure companies are not cheating.

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[5] Aronson, op. cit., p. 148.

While companies can be fined and chief executive officers even can be jailed for failure to comply with regulations, administrative guidance appears to be successful in keeping emissions within the standards, considered some of the strictest in the world (see Tables 1 and 2). Compliance rates above 90 percent for sulfur dioxide emissions, for example, were among the reasons cited for doing away with Class 1 designations for air pollution areas. These emissions dropped from a high of 0.059 parts per million in 1967 to well within the standards, which have been periodically revised since 1968 and now are set at 0.04 ppm as a daily average. Regulations that required application of the best available technology -- which led to extensive use of desulferization and denitrification equipment -- also helped decrease sulfur and nitrogen dioxide emissions throughout Japan. Government officials lately have been concerned, however, about an upward swing in nitrogen oxide levels. This increase has been blamed on the growing number of cars on the road and not stationary, industrial emissions.

Similar success through regulation, monitoring and administrative guidance has been achieved in decreasing water pollution caused by the toxic substances named in the 1970 Water Pollution Control Law: cadmium, cyanide, organic phosphorus, mercury and alkyl mercury compounds, some types of chrome, arsenic, lead and PCBs (polychlorinated biphenyls). The latest available Environment Agency survey on water quality in public water areas indicated that in FY 1987 about 0.02 percent of the samples exceeded the standards for the listed toxics. Some problems continue, however, in areas previously contaminated by mercury and PCBs, where cleanup efforts have been slow.

Discoveries in the 1980s of increased contamination of groundwater by trichloroethylene and tetrachloroethylene resulted in the Water Pollution Control Law being amended in 1989 to include these substances (see below). Thus, while Japan has made advances in air and water pollution that can be monitored closely, problems still arise in stemming pollution at a more individual level as well as in situations where monitoring has not been put into place.

Regulating Moving, Diffused Targets

As local and central government officials have moved from attacking easily targeted stationary pollution sources to more general pollution concerns, such as the solid and liquid wastes generated by households, problems have arisen in both organizing the attackers and defining the target. Solid waste regulations, for example, involve the Ministry of Health and Welfare, the Environment Agency and the Ministry of International Trade and Industry. All three have proposed legislation to counter the burgeoning waste problem, with MHW seeking to amend old laws and the other two proposing new statutes.

The 1971 passage of the Waste Disposal and Public Cleansing Law divided waste disposal responsibilities into those handled by municipalities and those managed in-house by industry. Toxic substances were to be buried only at specific, well-contained sites built to withstand earthquakes, rainwater incursion or corrosion. Approximately 39 such sites have been licensed in Japan. The other two types of disposal areas, those that control leachate and those that do not, number 1,080 and 1,181, respectively. The leachate facilities include treatment areas as well as lined landfills that also are designed to withstand earthquakes and flooding. Plastics, concrete blocks, glass and other items that

Table 1: International Comparison of Emissions of Sulfuric Oxides and Nitrogen Oxides

	Year	SO_x	NO_x	Population	GDP	SO_x/ Population	NO_x/ Population	SO_x/ GDP	NO_x/ GDP
Japan	1986	835	1,176	121,490	$1,206	6.87	9.68	0.69	0.98
United States	1986	21,200	19,300	241,613	4,086	87.74	79.87	5.19	4.72
West Germany	1986	2,223	2,969	61,066	636	36.40	48.62	3.50	4.67
Great Britain	1987	3,867	2,303	56,930	484	67.93	40.45	7.99	4.76
France	1987	1,517	1,652	55,630	545	27.27	29.70	2.78	3.03

Note: Emissions in kilotons. Population in thousands. GDP in billions of dollars converted at 1985 exchange rates.

Source: Organization for Economic Cooperation and Development, Environmental Data 1989.

Table 2: Japanese Standards for Air Quality and Compliance, FY 1968-FY 1988

	Standard	FY 1968	FY 1970	FY 1972	FY 1974	FY 1976	FY 1978	FY 1980	FY 1982	FY 1984	FY 1986	FY 1988
Sulfur Dioxide	0.1 ppm* 0.04 ppm**	0.055	0.043	0.031	0.024	0.020	0.017	0.016	0.013	0.012	0.010	0.010
Nitrogen Dioxide	0.04-0.06 ppm***	n.a.	0.022	0.20	0.027	0.027	0.028	0.027	0.025	0.025	0.026	0.028
Suspended Particulate Matter	0.02 mg/m3* 0.10 mg/m3**	n.a.	n.a.	n.a.	0.059	0.050	0.048	0.043	0.041	0.041	0.041	0.039
Carbon Monoxide	20 ppm average in 8 hours 10 ppm daily average	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ozone	0.06 ppm (1-hour value)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

*Hourly values.
**Daily averages.
***On a yearly average Japanese standards correspond to 0.02-0.03 parts per million.

Note: Monitoring of sulfur dioxide and nitrogen dioxide was carried out at 15 general stations in continuous operation. Monitoring of suspended particulate matter was handled at 40 general stations in continuous operation. Annual averages are derived from the sum of all one-hour values in the year divided by total measured hours.

Source: Environment Agency

pose no direct health risk are allowed to be dumped at the most basic landfills, although new efforts are being made to recycle these items. In general, when Japanese talk about the ever-increasing mountain of garbage, they mean the increase in household trash, which often includes that of small businesses and commercial enterprises that contract for disposal with municipal waste treatment facilities. Industrial waste disposal is also a problem, perhaps a more insidious one.

Reduce, Reuse, Recycle - Perhaps nowhere does the past conservatism of the Japanese life-style contrast as greatly with its current affluence as in the approach to household and commercial (as opposed to industrial) waste. Although Japan's per capita generation of 1.04 kilograms (2.3 pounds) of garbage a day -- based on FY 1987 figures -- is lower than that of the United States (see JEI Report No. 1A, January 5, 1990), the growth rate is such that authorities are predicting landfills in major cities will be full in two to four years. The issue has been called one of the most urgent facing Japan, particularly as urban populations turn to more and more disposable packaging and generate more and more faxes, computer memos and other one-time-use paper.

Times have changed from the days when few resources could be wasted in resource-poor Japan and independent collectors went door-to-door and exchanged toilet paper for old newspapers or other recyclable materials. An economically strong Japan is able to buy its resources from abroad. At the same time space limitations discourage the separation of aluminum cans, glass bottles and other recyclable materials. However, households still are encouraged to separate their valuable discards for pick up by neighborhood associations or independent recyclers. Collection services specify on which days they will pick up combustibles, incombustibles and bulk items. Local governments determine to what extent garbage should be separated by households.

Since recycling has some connection to space being available, success varies across the country. (See Table 3 for the recycling rates of various materials.) In Numazu, a town with 210,000 people in Shizuoka prefecture, reportedly more than half the cast-offs are recycled. Tokyo's 12 million residents appear less inspired, judging by records that show paper products routinely comprising about 45 percent of the trash collected by the municipal government.[6] Given the high price of land in Tokyo, it is somewhat surprising that all but one of Tokyo's 23 wards has a recycling center -- the central-city ward of Chiyoda being the exception.

The government has attempted pilot projects to encourage recycling centers, even incorporating them with incineration plants in some cases. In addition to collecting and separating reusable cast-offs, the projects engage in public awareness campaigns to minimize waste by Japanese society. For example, several of the pilot plants resurrect usable trash, such as pianos, that are then put in display rooms for viewing by those touring the facilities.

Although government and business have taken steps in-house to encourage recycling of waste paper or less gift wrapping in this presentation-conscious society, the waste management system in Japan does not put a premium on reduction. Even though Tokyo government officials have begun to seek dumping sites

[6] Tokyo no Gomi Ni, Ima Kodo wo ("Let's Have Action on Tokyo's Garbage") (Tokyo: Tokyo-to Seisokyoku, 1990).

Table 3: Recycling Rates of Various Waste Resources in Japan, FY 1982-FY 1988

(in thousands of metric tons and percentage of total production)

	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988
Waste Paper	8,357.6 (48.1%)	8,995.8 (49.1%)	9,636.5 (50.5%)	10,150.8 (50.2%)	10,510.5 (50.0%)	11,197.8 (49.6%)	11,957.1 (48.0%)
Aluminum Cans	16.0 (39.4%)	18.3 (40.2%)	21.8 (40.6%)	24.6 (40.6%)	28.8 (41.2%)	45.5 (41.5%)	62.2 (41.7%)
Steel Cans	385.7 (39.5%)	389.0 (39.9%)	341.0 (33.2%)	409.0 (37.9%)	428.0 (37.2%)	460.0 (37.1%)	509.0 (40.2%)
Glass Bottles	0.87 (42.0%)	0.95 (41.3%)	1.0 (42.4%)	1.1 (47.2%)	1.2 (55.2%)	1.2 (54.4%)	1.1 (49.2%)

Sources: Paper Recycling Promotion Center, Aluminum Can Recycling Association, Japan Used-Can Treatment Association and Federation of Glass Bottle Recycling

elsewhere in the country, garbage collection in the municipality is free to homeowners provided they keep the average daily weight below 10 kilograms (22 pounds). The charge for each kilogram (2.2 pounds) above that amount is Y22.5 ($0.17); a once-a-week collection of bulky items can be requested for which the homeowner pays only Y22.5 for each kilogram over 200 kilograms (440 pounds).

Although commercial enterprises are expected to handle their own waste -- usually by paying independent collection agencies -- the trash of small businesses, especially in areas where houses and shops mix, often is indecipherable from household garbage. ". . . [T]his pushes the amount of garbage collected to a level exceeding the incinerating capacity," according to Sukehiro Goto, the director of the Social Environment System at the National Institute for Environmental Studies. "As a result, unburnt garbage has to be dumped at reclamation sites. This in turn has drastically shortened the period the reclamation sites can meet the needs as dumping grounds from the originally planned five years."[7]

As Mr. Goto indicated, Japan's much-used incinerators, which eventually handle almost 73 percent of the country's waste (see Table 4), are swamped under the amount of garbage being produced in Japan. Land, not cheap nearest the cities where incinerators most commonly are used (see Table 5), is only part of the cost. Wary of the increased traffic from garbage trucks in the neighborhood and perhaps concerned about the facility's ability to eliminate or minimize noxious fumes, citizens hold out for extras. A common inducement is a promise to use heat generated by the incinerator to supply hot water to nearby housing or recreational complexes.

[7] "Cities Doomed To Drown in Garbage? A Talk Between Katsumi Yorimoto and Sukehiro Goto," Pacific Friend, XVIII, No. 10, p. 16.

Table 4: Municipal Waste Disposal by Treatment Category, FY 1987

(in metric tons per day)

			Treatment				
	Total Disposed	Landfill	Interim Treatment	Incinerator Facilities	High-Speed Composting	Composting and Feed	Other
Waste	100,530	15,377	n.a.	81,011	124	6	4,011
Bulky Waste	3,743	1,242	1,926	419	--	--	156
Direct Disposal	18,489	11,532	n.a.	6,672	6	6	272
Private Disposal	4,194	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total Handled	126,956	45,044*	1,926	89,117**	131	13	4,729

*Landfill totals include 28,151 tons a day in direct disposal plus 16,893 tons in processed refuse. This includes 14,500 tons from incinerators, 14 tons from high-speed composting facilities, 621 tons from bulk waste interim treatment facilities and 1,760 tons from unidentified "other" sources.
**Incineration facilities receive 1,015 tons from the interim treatment facilities for bulk waste.

Source: Clean Japan Center and Ministry of Health and Welfare

Table 5: Solid Waste Disposal Systems by Population Area, FY 1986

(in percent)

	11 Largest	300,000-500,000	100,000-200,000	Less Than 50,000	Towns/ Villages
Incineration	82.7%	76.1%	51.3%	40.8%	32.2%
Landfill	16.1	20.5	31.3	48.4	53.3
Resource Recovery and Other	1.2	3.4	17.4	10.8	14.6

Source: Ministry of Health and Welfare

Dross to Gold - While neither recycling nor incineration is adequate to counterbalance consumption in Japan, some bright spots exist in the ways technology is used to create energy or reshape resources. By FY 1983 at least 30 percent of the incineration plants used waste heat recovery boilers. Figures from the Health and Welfare Ministry show that Japan had 1,893 incinerators in FY 1987, of which 639 were continuous combustion type; the remainder were batch combustion.

Although at one time there were limits on transfers of generated electricity, the oil shocks of the 1970s ushered in a new era of cooperation. The excess electricity generated at one Tokyo waste facility last year, for example, was sold to Tokyo Electric Power Co., Inc. at prices ranging from Y4.5

($0.033) per kilowatt-hour during nonsummer months to Y7.5 ($0.056) per kilowatt-hour during the summer. The total for the year earned the facility about Y1.4 billion ($10.4 million).[8] Monitors at the municipally run waste plant operate continuously to show when it needs to buy electricity or when it has excess electricity that can be sold under contract to Tepco.

Other areas where technology eases the burden created by mountains of waste are in the creation of usable material from incineration ash or even the sludge left from treated sewage. Fertilizer, a familiar byproduct of composting or phosphorous-rich ash, is a less common use in modern Japan than construction materials, including cement as well as road and backfill components. A publication of the Clean Japan Center, a government and corporate-sponsored coordinator of recycling information, noted that a FY 1987 survey of industrial waste recycling found 1.2 percent of "combustion residue" being used for fertilizer, while 30 percent went into cement and concrete products and 12.6 percent to such civil engineering uses as road and backfill materials. Some of the incinerated municipal waste also gets "recycled" into such products. Thus, the Clean Japan Center differentiates between the approximately 36 percent of municipal waste that goes to a landfill and the remainder that is reduced through treatment (usually incineration) and recycled.[9]

Problems of Loose Controls - While municipal governments have scrambled to cope with a growing deluge of household and commercially generated garbage, the burden of industrial waste management has rested primarily on manufacturers. Although various regulations dictate where certain types of hazardous or nontoxic waste can be dumped, oversight has been a problem.

A Ministry of Health and Welfare survey from FY 1985, the latest available data, noted that industries recycled about 41 percent of the 312 million metric tons of waste they generated that year; about 136 million metric tons were treated and reduced, of which 25 million metric tons then were sent for recycling along with an estimated 104 million metric tons that were recycled directly. The rest, plus 72 million metric tons carted off without treatment, went directly to a dumping area. The category sent for disposal is of primary concern to regulatory officials, who are finding an increasing amount of waste that has been dumped illegally.

While manufacturers can consign disposal to one of the 56,538 firms licensed to handle industrial waste as of April 1987, they remain theoretically responsible for the ultimate proper disposal. A Japan Times editorial last year noted, "[T]he problem is that not a few smaller operators have been found to have illegally dumped industrial wastes in remote areas, posing a serious environmental problem to local residents."[10] The National Police Agency estimated at yearend 1990 that nearly 1.7 million metric tons of industrial material had been dumped illegally in the preceding 11 months, a figure almost twice the 1989 estimate of 870,000 metric tons. A majority of the illegal dumping involves construction materials. Some has involved improper disposal of medical wastes, which led the Ministry of Health and Welfare to draft guidelines in 1989 urging medical care and waste facilities to seek proper disposal methods.

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[8] Interview with Minoru Iida, head of the Oi Waste Treatment Plant, Tokyo Metropolitan Government, January 18, 1991.

[9] Clean Japan Center, Japanese Waste Management and Minimization (no date).

[10] "The waste problem worsens," Japan Times, February 2, 1990, p. 18.

In an indication of the difficulty of following the industrial waste trail the Police Agency pointed out that gangsters were involved in 11 of the 240 cases investigated in 1990. Of the 199 cases determined to have involved illegal dumping, 53 arrests were made, although the reports did not make clear whether the arrests were of the intermediary's or the corporation's officers. The Health and Welfare Ministry further acted last year to track industrial wastes through a "Manifest System," designed to require the discharging source to describe the form of waste and provide a manifest to determine the route and final treatment of the waste.

Another growing concern is that more industries may begin to look overseas for disposal of their wastes, particularly the hazardous variety. Japan has not yet signed the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes, a United Nations-sponsored treaty that is to go into effect this summer. However, a bill drafted by MITI is said to follow the intent of the treaty, which requires waste-accepting nations to approve the imports. The MITI bill also says waste exports would be allowed only if domestic handling would be difficult or if the products are to be recycled in the recipient nation. Approximately 45 toxic substances would require government approval for export; the ministry further hopes to expand domestic regulations to include the same 45 substances since less than 20 are regulated now.

Inattention and Infrastructure

Like most industrialized countries, Japan moved toward building up its economy often without thought to environmental harm, at least until various pollution crises caused alarms to ring in the late 1960s. While the compensation law and various regulations helped address immediate environmental health problems in the 1970s, growing affluence and urbanization outpaced government's oversight and highlighted areas where environmental, and possibly health, problems could arise because of the lack of well-developed sewerage and water treatment systems as well as other related types of public infrastructure.

Problems of Infrastructure - Slow improvements in surface water quality (see Table 6) and the increase in underground water pollution have led to various amendments aimed at strengthening the 1970 Water Pollution Control Law. But dual efforts brought about by health standards for drinking water supplies and technological advances in filtration and chemical treatment, which help improve safety as well as palatability, are in danger of being overwhelmed by increased strains on the water system from urban population concentrations. Particular blame for water pollution has been laid at the household door. A June 1990 amendment to the Water Pollution Control Law noted that household wastewater made up the majority of the organic water pollution in lakes, rivers and semi-enclosed bodies of waters. Household effluent was said to be responsible for 70 percent of the organic water pollution in Tokyo Bay, for example.

Prefectural governments have primary jurisdiction over water pollution problems; they have the authority to inspect for violations and impose penalties where appropriate. All the prefectures have instituted stricter standards

Table 6: Water Quality Compliance in Japan per Body of Water, FY 1979-FY 1988*

	FY 1979	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988
Coastal Waters	78.2%	79.8%	81.6%	81.%3	79.8%	81.3%	80.0%	81.2%	82.6%	82.7%
Rivers	65.0	67.2	63.3	65.3	65.9	63.4	67.7	68.6	68.3	73.0
Lakes, Reservoirs	41.8	41.6	42.7	41.7	40.8	42.7	41.2	40.0	43.1	43.3

*Based on the number of bodies of water to which environmental quality standards for the living environment are applied; these standards are distinct from health standards, which are applied to all bodies of water and limit toxic substances, such as cadmium, alkyl mercury, cyanide, organic phosphorus, lead, arsenic, chromium VI and PCBs. Environmental quality standards vary, depending on uses and body of water. Coastal waters must meet pH, chemical oxygen demand, coliform count and dissolved oxygen limits. Lakes and reservoirs are assessed for biochemical oxygen demand, dissolved oxygen and coliform count plus nitrogen and phosphorus. Rivers must meet the above plus limits on suspended solids.

Source: Environment Agency

than those imposed by the central government. In one area, though, the central government remains a key player: assistance with construction of sewerage systems. Subsidy rates vary according to location and whether the project is to build a treatment plant or trunk lines. Tokyo, for example, which began a concerted effort in the 1970s to extend sewer lines throughout the city (see Table 7), receives less help from the central government than do other areas. Subsidies, including grants, from the central government cover about half of

Table 7: Tokyo Municipal Government's Expenditures on Sewer Construction, FY 1965-FY 1986

(in billions of yen and percent of covered population)

Year	Outlay	Percent	Year	Outlay	Percent
FY 1965	Y23.0	35%	FY 1976	Y169.9	65%
FY 1966	26.7	39	FY 1977	183.9	68
FY 1967	33.9	42	FY 1978	200.8	70
FY 1968	38.5	45	FY 1979	240.3	72
FY 1969	39.3	48	FY 1980	221.1	74
FY 1970	49.6	48	FY 1981	225.7	76
FY 1971	80.5	52	FY 1982	240.3	78
FY 1972	113.2	55	FY 1983	224.9	80
FY 1973	119.5	58	FY 1984	221.2	82
FY 1974	153.4	60	FY 1985	235.3	83
FY 1975	158.4	63	FY 1986	247.6	85

Source: Tokyo Metropolitan Government, Sewerage in Tokyo, 1988.

project construction costs in Tokyo but approximately 75 percent of the overall costs in areas that have less infrastructure.[11]

Inadequate sewerage systems often are cited as one of the deficits in Japan's standard of living since only about 60 percent of the population in FY 1987 had some type of flush-toilet system (see Table 8). This figure includes septic systems (known as joukasou), which accounted for about 46 percent of the flush systems. Elsewhere in Japan services using vacuum hookups are hired to collect raw sewage, which they deposit in landfills or drying beds or even dump into storm sewer systems with little or no treatment. The 1990 water pollution control amendment specifically urged the public to treat waste cooking oil and

Table 8: Facilities in Planned Treatment Areas for Raw Sewage, FY 1975-FY 1987*

A: Number of Flush Toilet Systems

(in thousands)

	Public Sewer Systems	Purification/ Septic Tanks	Total	Share Served**
FY 1975	18,832	17,532	36,364	32.6%
FY 1980	26,324	26,867	53,191	45.5
FY 1985	35,542	32,323	67,865	56.0
FY 1987	39,801	33,536	73,337	60.1

B: Volume of Sewage in Nonflush Systems***

(in kiloliters per day)

	Planned Collection				
	Raw Treatment	Manhole Dumping	Farm Use	Ocean Dumping	Private Treatment
FY 1975	67,384	5,753	3,559	13,263	16,934
FY 1980	76,770	6,658	2,497	13,158	12,063
FY 1985	79,269	4,967	1,875	10,151	8,350
FY 1987	80,776	4,249	1,529	9,688	6,589

*Planned treatment areas accounted for 99.3 percent of the population in 1975, 99.6 percent of the population in 1980, 99.8 percent of the population in 1985 and 99.9 percent of the population in 1987.

**Percent of facilities in planned treatments areas served by flush toilet systems.

***Raw sewage volume is estimated by dividing total annual volume by 365.

Source: Ministry of Health and Welfare, Water Supply and Environmental Sanitation Department handle detergents economically to alleviate the pollution going into public water bodies.

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[11] Tokyo Metropolitan Government, Sewerage in Tokyo (Tokyo: Sewerage Bureau, March 1988).

The lack of sewage treatment systems played into the hands of U.S. negotiators at the 1989-90 Structural Impediments Initiative talks. They hoped Japan would increase funding for public infrastructure in an attempt to address a major, underlying cause of the bilateral trade deficit -- the gap between savings and investment in Japan. As a result of their promise to spend Y430 trillion ($3.2 trillion) on public works over the next 10 years, Japanese policymakers drafted a FY 1991-FY 1995 public works plan that calls for Y2.8 billion ($21 million) for sewage treatment facilities (see JEI Report No. 1B, January 11, 1991).

The influx of people into cities has had another spin-off: increased use of underground structures to accommodate transportation, housing and shopping facilities. This construction, in turn, has resulted in underground water being pumped out, which has caused subsidence problems. Another concern about increased construction is that it prevents natural seepage and encourages the artificial channeling of rainwater and other runoff, which often ends up being untreated until needed for drinking water.

Disrupted Water Supplies - The Health and Welfare Ministry moved in 1989 to expand its attack on toxic substances that threaten the safety of drinking water by adding trichloroethylene and tetrachloroethylene to the list of harmful substances regulated by the 1970 Water Pollution Control Law. Recent surveys of groundwater throughout Japan indicated that three harmful substances -- trichloroethylene, tetrachloroethylene and a form of trichloroethane -- were showing up in greater-than-recommended quantities. In one survey tetrachloroethylene, in fact, surpassed recommended levels in 11.8 percent of the tested wells. Almost all of these, 11.6 percent, were used for drinking water.

Although not the main source of drinking water in Japan, subterranean water nevertheless supplies about 22 percent of the country's drinking water needs (see Table 9). In some places wells may be the only source of water, making preservation of groundwater of paramount interest. The attitudes shown by the Environment Agency's 1989 annual report and MHW's similar report that same year underscored different perceptions about pollution prevention and the development of alternatives. The Environment Agency stated, "It is clear that measures must be taken to prevent pollution before it develops much, since groundwater, once polluted cannot be restored easily." The Health and Welfare Ministry suggested, ". . . over recent years there has been a deterioration in the hygienic condition of wells due to the pollution of underground water, so that there is now the problem of how to supply areas which are no longer provided for."

No Overriding Ethic

The lack of an overarching approach to environmental regulation in Japan can be seen from various bureaucracies sharing joint responsibilities but advocating goals that might be at odds. The Ministry of Construction, for example, has authorized a dam on the Nagara River for flood control, among other reasons. Last year the then Environment Agency chief urged further environmental impact assessments, questioning along with opponents of the dam whether adequate attention had been paid to the impact the dam could have on various rare

Table 9: Water Consumption in Japan by Use and Source*

(consumption in billion cubic meters annually)

	Consumption	Surface Water	Ground Water**
Industry	10.33	7.24	3.09
Tap and Drinking Water	14.93	11.61	3.32
Agriculture	57.0	53.25	3.75
Buildings and Other	n.a.	n.a.	1.16

*Based on surveys taken in 1986 for tap water and industrial statistics. Data for agricultural land assessed from 1973 surveys by the Ministry of Agriculture, Forestry and Fisheries. The use of water for businesses and other buildings was determined by Environment Agency surveys from 1971 to 1987.
**Includes wells and springs.

Notes: Industry as defined by the Ministry of International Trade and Industry and calculated as operating 300 days a year.
Tap water also is supplied to industries, causing an overlap of end-use figures of about 690 million cubic meters a year.

Source: Environment Agency

fish and water quality. The current head of the Environment Agency has backed away from the issue, reportedly telling the press, "This is not within the jurisdiction of the Environment Agency." A similar comment from the head of this country's Environmental Protection Agency would be unusual, given EPA's ability to challenge the environmental soundness of federal projects under the National Environmental Protection Act.

Another problem of shared responsibilities is that bureaucratic turf wars can slow the drafting of regulations aimed at counteracting pollution problems. A good example is the dispute over whether to revise the current solid waste management statutes, the position advocated by MHW, or craft new legislation, the approach favored by MITI and the Environment Agency.

A Question of Recycling Old Lessons

Japan has responded to pollution problems in a variety of ways. Like most industrialized countries, reaction rather than foresight has been the rule. That concept, however, ignores fortuitous regulations that may have averted or alleviated unknown dangers.

The 1973 compensation law raised hopes among environmental activists of holding polluting companies responsible for their actions. While the statute established a polluter-pays precedent, subsequent revisions may have created some hesitation for assigning blame without a preponderance of scientific evidence. Nevertheless, the law continues to connect companies, through levies on emissions, to broader efforts to improve the downwind and downstream environment. Japan's strict air quality standards, partly resulting from attention to health concerns associated with passage of the 1973 compensation law, positions the country to combat some of the gases thought to cause global warming, especially sulfur dioxide and nitrogen dioxide. Success in monitoring these two gases hints at the possibility of also monitoring emissions of carbon dioxide, another gas held responsible by many scientists for global warming.

One of the problems with the compensation law, however, has been the drawn-out process of trying to qualify for the measure's benefits. Another problem with future use of this law and similar attempts to pinpoint blame for health-damaging pollution is that those who try to seek redress often are considered rabble-rousers in a society fond of noting that the nail that sticks out gets hammered. The compensation law has proved to be effective but at some expense to both individual sufferers and society.

Another effective Japanese way of handling pollution matters also has had its downside. Government-corporate cooperation has been handy whenever one ministry has had the ability to exercise firm "guidance," for example in adjusting air pollution emissions. But the strong ties between various ministries and industries also can complicate application of an overall environmental ethic, similar to the review of economic and environmental factors required by America's National Environmental Protection Act.

One of Japan's pollution control lessons, the effectiveness of technology, has been singularly successful on a variety of fronts, ranging from diminishing pollution at the source to reshaping treated waste into a new, recycled product. But even technology is no deus ex machina when urbanization and affluence put more demands on a system than it is capable of handling. Particularly in relation to problems tied to insufficient public infrastructure, Japan may be learning the drawbacks of not addressing some problems earlier. The latecomer syndrome, which helped Japan capitalize on the technological achievements of others as it drove to greater economic success, also has a downside.

Appropriate application of Japan's past lessons in pollution control to other countries, especially those in the Third World, would entail cautions about not relying too much on technology as well as recommendations for a strong working relationship between industry and government, tempered by an ethic that balances economic advantages with necessary health and environmental considerations. These are lessons not only for developing countries but for future contingencies in Japan, as well.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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ON THE VERGE OF 1992: JAPAN AND THE EUROPEAN COMMUNITY

Summary

The 12 nations of the European Community are less than a year away from the start of a plan to more completely integrate their economies into a true common market covering all goods and services. Such a momentous change naturally is having a broad impact not only within Europe but externally as well, as can be seen in the EC's shifting relations with its major trading partners. Both Tokyo and major Japanese companies face many uncertainties in trying to adapt to Europe 1992, since the EC has not yet drawn up all the rules for the new economic union.

Background

After a fashion, the postwar development of Japan and the 12 nations that now make up the European Community* followed many parallel paths. Both depended on the United States for military security, including coverage by the American nuclear umbrella: the EC via the North Atlantic Treaty Organization; Japan under the aegis of the U.S.-Japan Mutual Security Treaty. The United States also played a large role in the economic life of the EC and Japan, both as a source of capital and technology and as a supplier and a buyer of goods. Conversely, the level of economic interdependence between the EC and Japan was very low; bilateral security relations were almost nonexistent. As a result, postwar Japan-EC relations have been stunted, overshadowed by the economic and political dominance enjoyed, until recently, by the United States.

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*Member countries of the European Community are: Belgium, France, Italy, Denmark, Greece, Luxembourg, the Netherlands, Ireland, Portugal, Spain, Germany and the United Kingdom.

This uneven tripartite relationship is now in flux. New parallels between Japan and the EC are emerging. In terms of relative economic size the United States no longer is head and shoulders above the other two. Japan's total output of goods and services is about two-thirds that of the United States; moreover, its economy consistently has exhibited a much higher rate of real growth. When the EC's 1992 plan is activated fully, the community's population and economic output will be greater than that of the United States by about one-third and one-quarter, respectively. In specific markets Japanese and European manufacturers now lead the United States, and international competition among the three is growing ever more intense.

In the military area the Persian Gulf crisis not only underscored the continuing international leadership position of the United States but, perhaps more significantly, suggested a new era of allied cooperation on security issues around the world (even if, as in Japan's case, such support does not involve personnel or equipment). Greater allied cooperation on world security matters was a central element of Washington's international strategic plan even before Iraq invaded Kuwait; for example, Japan's self-defense forces are a cornerstone of the U.S. strategy for Northeast Asian security. But Operations Desert Shield and Desert Storm demonstrated that a multinational approach to global security problems can work.

The economic and military convergence of the EC and Japan with the United States have drawn both Brussels and Tokyo closer to the center of action in global affairs. Whether either is up to the challenge, however, remains an open question. The Iraq-Kuwait war showed that EC members individually could launch diplomatic initiatives apart from the United States, but that collective action as the European Community still was lacking. Similarly, Japan's performance under stress has raised questions about its qualifications for global political leadership. Economically, too, the two face fresh challenges commensurate with their new influence. The reason the current Uruguay Round of multilateral trade negotiations is stalled, from Washington's standpoint, is the failure of both the EC and the Japanese governments to resist parochial pressures and act in the interests of the entire global economy.

With both the EC and Japan groping for their new places in global affairs, it is not surprising that bilateral ties are changing. Making the situation more volatile is the pending action on the many important details necessary for implementing the EC's 1992 plan -- details equally important to EC members and their trading partners. As the two actors step away from their supporting roles and into the spotlights, they must deal with a long list of long-standing bilateral issues as well as with new issues raised by their reemergence as major powers in global affairs.

Past Frictions

Trade, in a word, sums up the issues that have hampered smooth EC-Japan relations during much of the postwar era. Aggregate trade flows as well as disputes over specific products have generated friction. From an overall trade standpoint the EC-Japan dialogue often echoes the U.S.-Japan relationship. Just

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as it does with the United States, Japan runs a sizable trade surplus with the EC as a whole. Similar to the response by Washington, Brussels and individual member governments have harangued Tokyo to lift tariff and nontariff barriers and to curb "unfair" trade practices, whether instituted by the government or by Japanese companies. Trade statistics highlight the EC's cause for concern but also portend an improvement.

Trade Balances - Tables 1 and 2 chronicle Japan's trade with the EC and with selected EC members in both dollar and yen terms. The expansion of Japan's surplus with the EC in the mid-1980s truly was spectacular when viewed in dollars: 50 percent in 1986 and 20 percent the following year. Hardly causing comment, however, is the trade balance denominated in yen. The surging growth of imports (from the EC as a whole and from most members individually) in the 1988-90 period and the corresponding decline in Japan's surplus (viewed in terms of either currency) have provided solace to both Japanese and EC policymakers, but there is no consensus that these trends will continue. Because the absolute value of exports to the EC is so much higher than that of imports from the community, Japan would have to buy significantly more than it sells to cut the trade surplus to a politically sustainable level. Even if the surplus continues to drift downward, the imbalance probably will remain of sufficient size to generate bilateral friction for years to come.

While Japan's surplus with the EC as a whole hit a peak in 1987 in yen terms and in 1988 in dollar terms, its surplus vis-a-vis individual EC members shows a more mixed pattern, reflecting various members' national trade policies and economic situations. Countries with tight import controls on major Japanese products (France and Italy, for example) generally have shown a fluctuating mix of surpluses and deficits with Japan. Countries with less rigid controls (especially West Germany, Great Britain and the Netherlands) have experienced a consistently large deficit with Japan, influenced by the strength of domestic demand. Britain's flat economic performance in 1989 and 1990, for example, resulted in a drop-off in purchases from Japan.

A breakdown of Japan's trade with the community by major product groups (Tables 3 and 4) points to the comparative strengths and weaknesses of the two competitors. In line with relative resource endowments, trade in food products leans heavily in the EC's favor, while the balance of trade in many manufactured goods leans toward Japan. The international competitive position of Japanese makers of computer equipment and other office machines, machine tools, industrial and consumer electronics goods, motor vehicles and precision equipment is clear from the large surpluses they have enjoyed vis-a-vis the EC. EC manufacturers have built a surplus in one area -- chemicals; this strength to a large extent reflects the EC's highly competitive pharmaceutical industry and the cost edge European producers have in plastics and other petrochemical derivatives.

Even though exports to the community still outweigh imports from it by a wide margin, import growth in the 1988-90 period was impressive, spanning both manufactured products and industrial and agricultural inputs. Purchases of EC-made manufactured products climbed from $15.2 billion in 1987 to $24.2 billion in 1989 -- a 59.7 percent gain that was in line with the 59.1 percent jump in imports of manufactures from the United States over the same time frame. The expansion picked up speed in 1990, with purchases rising 27.6 percent to $30.9 billion versus a 15.5 percent increase to $32.5 billion in U.S.-sourced goods.

Table 1: Japan's Trade with the European Community and Selected EC Members

(in millions of dollars and percent change)

	Exports		Imports		Balance	
	Value	Change	Value	Change	Value	Change
European Community						
1990	$53,510	11.7%	$35,063	24.6%	$18,447	-6.6%
1989	47,908	2.2	28,146	16.9	19,761	-13.3
1988	46,873	24.3	24,071	36.2	22,802	13.9
1987	37,693	22.9	17,670	26.3	20,023	20.0
1986	30,675	53.3	13,989	57.3	16,686	50.0
Great Britain						
1990	10,782	0.4	4,765	6.7	6,017	-4.1
1989	10,741	1.0	4,466	6.5	6,275	-2.5
1988	10,632	26.5	4,193	37.2	6,439	20.5
1987	8,400	26.4	3,057	-14.4	5,343	73.8
1986	6,647	40.7	3,573	96.6	3,074	5.8
West Germany						
1990	17,777	11.7	11,487	27.7	6,290	-9.2
1989	15,920	0.8	8,995	10.9	6,925	-10.0
1988	15,793	23.1	8,101	31.8	7,692	15.1
1987	12,833	22.5	6,150	43.1	6,683	8.2
1986	10,477	51.0	4,298	46.8	6,179	54.1
France						
1990	6,124	15.6	7,586	26.8	-1,462	489.5
1989	5,298	6.3	5,546	28.6	-248	**
1988	4,986	24.2	4,313	50.2	673	-41.1
1987	4,014	27.3	2,871	54.8	1,143	-11.9
1986	3,152	51.3	1,855	40.1	1,297	70.9
Italy						
1990	3,410	22.5	5,007	31.6	-1,597	56.1
1989	2,783	-0.0	3,806	31.6	-1,023	847.2
1988	2,787	32.5	2,895	35.5	-108	237.5
1987	2,103	22.1	2,135	42.8	-32	**
1986	1,723	54.3	1,495	42.4	228	240.3
Denmark						
1990*	883	16.5	1,046	-12.8	-163	-63.0
1989	758	-4.3	1,199	5.0	-441	26.0
1988	792	-13.6	1,142	21.0	-350	1196.3
1987	917	-7.3	944	20.9	-27	**
1986	989	30.5	781	34.9	198	10.6
Netherlands						
1990*	5,521	8.0	1,071	-4.5	4,450	11.5
1989	5,112	1.1	1,122	12.7	3,990	-1.7
1988	5,054	24.1	996	31.6	4,058	22.5
1987	4,071	24.8	757	31.2	3,314	23.5
1986	3,261	57.5	577	31.4	2,684	64.5
Spain						
1990*	1,895	-2.4	736	32.4	1,158	-16.4
1989	1,941	4.4	556	3.5	1,385	4.7
1988	1,860	38.5	537	50.4	1,323	31.2
1987	1,343	24.8	357	20.2	986	26.6
1986	1,076	77.9	297	-15.1	779	205.5
Greece						
1990*	746	29.1	145	-18.1	601	49.9
1989	578	28.2	177	29.2	401	27.7
1988	451	1.1	137	98.6	314	-16.7
1987	446	-20.8	69	-4.2	377	-23.2
1986	563	-2.4	72	14.3	491	-4.5

*January-November 1990; percentage change based on the same period of 1989.
**Meaningless.

Source: Ministry of Finance

Table 2: Japan's Trade with the European Community and Selected EC Members

(in millions of yen and percent change)

	Exports		Imports		Balance	
	Value	Change	Value	Change	Value	Change
European Community						
1990	Y7,732,983	17.6%	Y5,075,360	31.1%	Y2,657,623	-1.8%
1989	6,577,895	9.6	3,870,210	25.6	2,707,685	-7.3
1988	6,002,754	9.4	3,082,865	20.2	2,919,898	-0.1
1987	5,487,963	6.1	2,564,847	9.2	2,923,116	3.5
1986	5,173,677	8.5	2,348,282	10.4	2,825,395	7.0
Great Britain						
1990	1,562,177	6.0	756,426	23.4	805,751	-6.3
1989	1,473,087	8.2	612,966	14.3	860,121	4.2
1988	1,361,791	11.6	536,179	21.0	825,612	6.2
1987	1,220,781	8.7	443,096	-25.3	777,685	46.8
1986	1,122,837	-0.8	593,175	37.2	529,662	-24.3
West Germany						
1990	2,564,922	17.3	1,661,698	34.3	903,224	-4.9
1989	2,186,563	8.1	1,237,021	19.2	949,542	-3.7
1988	2,022,411	8.1	1,036,659	16.2	985,752	0.8
1987	1,871,028	5.9	893,045	23.1	977,983	-6.0
1986	1,766,215	7.3	725,473	3.7	1,040,742	10.0
France						
1990	885,982	21.8	1,098,417	44.2	-212,435	413.3
1989	727,250	13.9	761,886	37.8	-34,636	**
1988	638,717	9.4	553,056	33.0	85,661	-49.0
1987	583,796	9.7	415,691	33.4	168,105	-23.8
1986	532,272	7.4	311,671	-1.6	220,601	23.3
Italy						
1990	442,149	15.5	727,191	38.6	-285,042	101.2
1989	382,827	7.3	524,524	41.3	-141,697	876.7
1988	356,830	17.0	371,337	19.3	-14,507	138.0
1987	305,111	5.1	311,206	24.1	-6,095	**
1986	290,424	9.4	250,820	-4.7	39,604	196.9
Denmark						
1990*	128,432	23.1	153,318	-7.1	-24,886	-58.9
1989	104,353	3.1	164,972	12.6	-60,619	33.7
1988	101,232	-24.5	146,556	7.2	-45,324	1653.3
1987	134,066	-19.8	136,651	4.1	-2,585	**
1986	167,117	-8.2	131,250	-5.2	35,867	-17.6
Netherlands						
1990*	805,273	14.6	155,885	1.3	649,388	18.3
1989	702,786	8.6	153,840	20.6	548,946	5.6
1988	647,231	9.0	127,588	15.9	519,643	7.4
1987	593,779	8.2	110,053	13.0	483,726	7.1
1986	549,004	11.9	97,356	-7.5	451,648	17.2
Spain						
1990*	277,026	4.0	106,530	40.0	170,496	-10.4
1989	266,433	11.8	76,107	10.6	190,326	12.3
1988	238,320	22.3	68,832	32.7	169,488	18.5
1987	194,857	8.1	51,857	2.1	143,000	10.4
1986	180,282	25.8	50,804	-39.3	129,478	117.1
Greece						
1990*	108,630	36.6	21,297	-12.6	87,333	58.4
1989	79,516	37.8	24,376	39.4	55,140	37.2
1988	57,685	-12.2	17,490	71.6	40,195	-27.6
1987	65,709	-30.3	10,192	-18.0	55,517	-32.2
1986	94,271	-33.8	12,433	-20.7	81,838	-35.4

*January-November 1990; percentage change based on the same period of 1989.
**Meaningless.

Source: Ministry of Finance

Table 3: Japan's Dollar-Denominated Trade with the European Community by Product Group

(In millions of dollars; exports f.o.b., imports c.i.f.)

	1985	1986	1987	1988	1989	1990*
Exports						
Food	$72	$120	$152	$149	$150	$122
Textiles and Clothing	457	736	779	826	822	873
Chemicals	939	1,403	1,792	2,270	2,390	2,547
Pharmaceuticals	107	154	187	239	254	285
Plastics	175	281	335	447	492	534
Nonmetallic Mineral Manufactures	143	225	235	310	299	320
Metals and Fabricated Metal Products	544	738	723	958	1,096	1,102
Machinery and Transport Equipment	15,881	24,575	30,601	38,262	38,988	3,901
Power Generating Machinery	272	476	692	886	936	912
Computers and Other Office Machines	1,752	3,124	4,054	5,288	5,277	5,520
Machine Tools	340	535	591	722	897	946
Electric Power Machinery	163	248	318	460	448	428
Televisions	143	167	150	216	277	383
Radios	445	589	567	571	602	678
Electronic Tubes and Semiconductors	818	1,070	1,187	1,723	2,105	1,849
Motor Vehicles	3,039	5,225	6,944	8,496	8,436	8,539
Motorcycles	310	521	711	772	845	966
Precision Instruments	1,830	2,589	2,965	3,506	3,641	3,575
Other	1,980	2,879	3,411	4,097	4,164	4,281
Total	20,016	30,675	37,693	48,873	47,908	53,510
Imports						
Food	976	1,399	1,791	2,404	2,867	2,857
Textile Fibers	88	88	154	134	161	86
Metal Ores and Scrap	40	39	122	114	129	138
Mineral Fuels	80	192	104	154	201	168
Other Raw Materials	224	314	352	494	556	550
Chemicals	2,131	2,918	3,873	5,000	4,968	4,755
Pharmaceuticals	434	690	957	1,282	1,338	1,231
Machinery and Transport Equipment	2,339	3,677	5,445	7,138	8,635	10,963
Computers and Other Office Machines	83	121	180	209	254	270
Power Generating Machinery	90	113	174	165	177	195
Machine Tools	82	124	103	143	169	251
Aircraft	27	118	98	228	188	228
Precision Instruments	225	297	374	394	419	484
Others	3,014	5,361	5,828	8,632	10,630	12,575
Steel	49	94	89	186	148	169
Nonferrous Metals	233	259	381	892	788	704
Textiles and Clothing	672	943	1,307	1,762	2,417	2,794
Total	8,893	13,989	17,670	24,071	28,146	35,063

*January-November 1990.

Source: Japan Tariff Association

Table 4: Japan's Yen-Denominated Trade with the European Community by Product Group

(in millions of yen; exports f.o.b., imports c.i.f.)

	1985	1986	1987	1988	1989	1990*
Exports						
Food	Y17,287	Y20,170	Y22,109	Y19,135	Y20,617	Y17,810
Textiles and Clothing	107,994	123,732	112,959	105,731	113,065	127,597
Chemicals	223,944	236,613	260,645	290,377	328,012	372,731
Pharmaceuticals	25,374	26,050	27,180	30,530	34,901	41,348
Plastics	41,798	47,352	48,783	57,182	67,557	78,116
Nonmetallic Mineral Manufactures	34,156	38,132	34,160	39,712	41,144	46,621
Metals and Fabricated Metal Products	128,934	124,827	104,907	122,723	150,560	160,968
Machinery and Transport Equipment	3,784,420	4,145,875	4,457,740	4,900,063	5,351,821	5,694,728
Power Generating Machinery	64,849	79,986	100,357	113,391	128,076	132,709
Computers and Other Office Machines	418,380	523,706	588,320	677,876	727,170	805,950
Machine Tools	80,311	90,694	85,402	92,395	123,978	138,282
Electric Power Machinery	38,786	41,747	46,131	58,953	61,627	62,538
Televisions	34,060	28,167	21,780	27,636	38,246	55,671
Radios	105,784	98,657	82,658	73,382	82,984	98,847
Electronic Tubes and Semiconductors	196,600	180,135	172,074	220,647	289,523	270,655
Motor Vehicles	722,769	892,540	1,019,928	1,086,383	1,152,009	1,223,344
Motorcycles	73,873	89,885	103,840	98,083	115,033	140,640
Precision Instruments	433,968	436,151	430,826	449,227	501,203	521,649
Other	471,269	484,328	495,443	525,013	572,678	624,312
Total	4,768,004	5,173,677	5,487,963	6,002,754	6,577,895	7,732,983
Imports						
Food	232,134	235,493	259,643	307,898	395,795	415,946
Textile Fibers	21,153	14,840	22,552	17,127	21,899	12,567
Metal Ores and Scrap	9,713	6,710	17,660	14,573	17,780	19,967
Mineral Fuels	19,904	34,017	15,532	19,694	27,293	24,588
Other Raw Materials	53,701	53,497	51,241	63,204	76,254	80,165
Chemicals	511,285	492,075	562,756	640,703	679,453	695,285
Pharmaceuticals	103,869	116,043	138,933	164,319	183,152	179,726
Machinery and Transport Equipment	559,132	619,981	790,906	913,279	1,190,045	1,600,811
Computers and Other Office Machines	19,628	20,243	25,985	26,734	35,157	39,242
Power Generating Machinery	21,314	19,259	25,206	21,074	24,221	28,214
Machine Tools	19,563	20,660	15,040	18,241	23,185	36,479
Aircraft	6,462	20,791	14,166	29,261	26,010	33,488
Precision Instruments	53,445	50,183	54,441	50,453	57,682	70,579
Others	719,512	891,670	844,557	1,106,386	1,461,691	1,837,022
Steel	11,835	15,999	12,968	23,826	20,562	24,850
Nonferrous Metals	56,031	44,055	54,728	114,729	108,001	102,815
Textiles and Clothing	161,309	157,849	190,642	226,710	333,556	409,858
Total	2,126,894	2,348,282	2,564,847	3,082,865	3,870,210	5,075,360

*January-November 1990 only.

Source: Japan Tariff Association

More significantly, imports of some high-profile EC manufactured goods showed strong gains, with EC shipments of office machines, machine tools, precision equipment and aircraft breaking out of the narrow zones in which they had fluctuated during the mid-1980s.

Of course, the role of exchange rates in influencing trade flows cannot be ignored. The shifting value of the yen against major European currencies clearly amplifies or diminishes the value of exports, imports and the resulting trade balance. (The linkage by EC countries -- and soon Britain -- of their currencies within the European Monetary System, in which the Deutsche mark plays a major role, means that the yen moves in a similar direction against most European currencies.) Yet from this standpoint there is some reason for optimism. In both 1989 and 1990 the yen fell against the Deutsche mark (16 percent and 6.2 percent, respectively, based on a comparison of yearend rates); it also was lower against the British pound (1.2 percent and 11.4 percent, respectively). Nevertheless, this depreciation, which makes European goods more expensive from Japan's viewpoint, did not stunt Japanese imports from most EC countries. Imports in both years recorded very strong growth. The reasons for this impressive European export performance are not all clear; strong Japanese consumer demand for European luxury goods and cars is an oft-cited factor.

Rules of the Game - How the two sides have approached trade policy and bilateral trade negotiations is another study in parallels. In contrast to the United States, Japan's government and those of most EC members traditionally have played a major role in economic matters. In addition to providing indirect support to domestic businesses through strong social welfare spending (primarily health care and education), these governments for the most part have acted directly to promote specific industries via tax and trade policies as well as research and development expenditures. (Washington certainly engages in all these activities but to a lesser degree and not with such specificity.) In other words, economic policymakers in Japan and in many European countries accept industrial policy as a legitimate pursuit. Additionally, agricultural policy is important to both Japan and the EC, with the farm tradition occupying a special niche in their national psyches. More specifically, Japanese and European farmers are highly influential in national politics.

These similar activist attitudes make it no surprise that bilateral trade relations have been marked by numerous cases of direct government action. In the immediate postwar years Tokyo sought to protect Japan's war-ravaged industries by limiting imports of almost all manufactured goods; it also indirectly controlled import flows through a tight rein on foreign exchange transactions. These restrictions gradually were eliminated in the 1960s and the first part of the 1970s. Over the same period European discrimination against Japanese products also declined, but the process stopped far short of an open market, particularly in France and Italy. To this day both countries control imports of cars from Japan as well as a number of other products through formal agreements. France, Italy and some additional EC members also limit several other goods through voluntary restraint agreements. Every such arrangement has one purpose only: to protect weaker European companies from the competitive might of the Japanese.

Because the EC's basic function is to promote the health and well-being of its members, it has toughened its trade negotiating position as Japan and other countries have mounted competitive challenges in industry after industry.

The community has strong antidumping regulations and has shown that it is unafraid of using them; the list of Japanese products that have been or are the target of EC antidumping-duty penalties is not brief. The most recent addition is blank audio cassette tapes. The EC also has occupied itself uncovering "unfair" Japanese trade practices that might hurt EC exports or put European firms at a competitive disadvantage. Japan's differential tax on alcoholic beverages, which featured a steeper tax on high-quality beverages such as European liquor, essentially was eliminated in 1987 after a steady EC lobbying effort. Most recently, the community has launched an investigation into the structure of Japanese harbor charges after allegations from European shippers that they are charged more than Japanese boats for the same services.

This tough EC negotiating stance on trade suffered a setback in 1990 when a world trade body handed Tokyo a victory in its case against certain EC antidumping practices. In 1987 the EC extended antidumping duties on imports of finished goods to locally produced versions assembled from imported parts. The community argued that Japanese exporters were circumventing the duties placed on finished goods by setting up "screwdriver" operations in the EC. Tokyo charged that the EC practice violated the rules of the General Agreement on Tariffs and Trade and asked for GATT arbitration after bilateral talks failed to resolve the issue. A GATT panel agreed that the EC action contravened GATT rules; however, the community so far has blocked final adoption of the ruling and appears ready to defy its trading partners on this issue.

Trade disputes remain a constant feature of bilateral relations; negotiated settlements are the exception rather than the rule. Last year, though, Japan and the EC agreed to hold regular ministerial-level meetings to address bilateral trade issues -- a sign that both sides are assigning a higher priority to bilateral economic ties. But the new forum is not expected to stop the bickering, if anything it will intensify as the community grapples with its plans for 1992.

1992: New Opportunities and New Problems

The EC's economic integration plan is nearly all encompassing. Internal customs structures will be swept away and external customs structures will be harmonized and unified. Another goal of the plan is to create a single internal market by December 31, 1992 for all professional and financial services, while at the same time harmonizing the rules governing foreign activities in these areas. Intellectual property rights will become more uniform within the community. Industrial, safety and environmental standards also will begin to be harmonized. While monetary and fiscal policies will remain under the control of sovereign members, the tighter economic union eventually will force convergence of interest rate and tax policies. Preparations for a central EC monetary authority (analogous to the Federal Reserve Bank in the United States) are under way. To keep businesses from moving to another EC country governments are studying how to match each others' tax incentives and limit disincentives. This move undoubtedly will foster regulatory convergence, since such rules figure prominently in corporate evaluations of the local business climate.

Rulemaking Worries - The attraction to foreign firms of the EC's consolidation is obvious: the creation of a borderless consumer and industrial market some 320 million people strong. Although the EC steadfastly has stated that it does not intend to create a "fortress Europe" that will shut foreigners out of its enlarged market, officials make no bones about drawing up rules that explicitly or implicitly acknowledge differences in how domestic and foreign firms are treated. In professional services, for example, EC members have agreed that mutual recognition of professional accreditations will be the general rule for domestic -- but not necessarily foreign -- practitioners. In fields such as legal services foreign professionals may be treated less generously after 1992 than before. But new opportunities may open for foreign-based firms in some areas. Particularly in financial services foreign companies will receive essentially the same treatment as their domestic rivals.

One worrisome trend for government and business in the United States and Japan is the EC's tilt toward reciprocal national treatment -- giving foreign firms the same treatment in the home market that domestic companies receive in foreign markets. Unilateral national treatment -- treating domestic and foreign firms uniformly at home regardless of how local companies are treated abroad -- is the preferred concept in Washington. The EC, however, has adhered to reciprocal national treatment as its basic approach to developing new business rules for 1992. The concept of reciprocity is theoretically attractive but often difficult to employ in the real world because of varying economic and regulatory structures. Both Tokyo and Washington are keeping a wary eye on how the community incorporates and implements this concept.

Nailing down the myriad details necessary to implement a true economic union stands out as a major challenge for the EC, one that its trading partners are watching carefully. Two-thirds of the roughly 280 proposed implementing directives have been enacted. The EC Commission develops these model directives, which, in turn, must be approved by member governments' own legislatures before taking efect. EC members have been especially slow to act on politically sensitive directives. Harmonizing value-added tax rules is a prime example of foot-dragging that threatens the 1992 plan. The EC Commission has chastised its members, saying that despite their unanimous commitment to harmonize VAT structures, "no precise measures have been taken" by any of the 12. Such indecision and sluggishness create uncertainties, an abhorrent situation to business planners. Some Japanese firms are postponing decisions regarding EC operations because they fear that making a choice now may be like building a house on shifting ground. One industry, in particular, highlights how this new problem can exacerbate a preexisting dispute.

The welcome extended to Japanese motor vehicle exporters by EC members ranges from open arms to closed fists. France, Italy and Spain impose very tight limits, Portugal and England less stringent ones. Germany and a few others have no restraints at all. The EC has been negotiating a unified position on Japanese car exports with both its members and Tokyo for more than a year, but a solution remains out of reach because of determined opposition from some members. The latest proposal would allow Japanese-made cars to capture as much as 18 percent of the combined EC market over five years beginning in 1993. A clause requiring cuts in Japanese exports in the event of a market downturn reportedly exists, however. In Japan's eyes this approach is an improvement over the hard-line French and Italian position of a 10 percent market share cap lasting 10 years but is worse than the shorter transition period advocated by the British and the Germans. Estimates put 1990 sales of Japan-badged cars at slightly less than 10 percent of the EC market; this rises to nearly 12 percent if trucks are included.

What also must be decided is how to treat vehicles assembled in the community by Japanese-owned subsidiaries or joint ventures with Japanese participation. Some members want all cars built by the Japanese to be counted, even Europe-bound vehicles produced in U.S. factories. Britain, where three major Japanese automotive makers have or are building production facilities, strongly opposes this position. While Tokyo reportedly has agreed to most points of the proposal, the Ministry of International Trade and Industry has said the inclusion of locally assembled cars in quota calculations is unacceptable. The EC Commission has threatened legal action against governments that continue individual car quota policies after 1992, but it is uncertain whether a uniform position can be hammered out that also would be acceptable to Japan.

Japanese motor vehicle manufacturers have resigned themselves to the political necessity of a voluntary restraint agreement. MITI has had talks with Toyota Motor Corp. (which has 2.6 percent of the EC market), Nissan Motor Co., Ltd. (2.7 percent), Mazda Motor Corp. (2 percent) and Honda Motor Co., Ltd. (1.1 percent) about the delicate situation. Some observers think these talks are a prelude to limited export growth to the EC this year and next, so as not to give EC protectionists added ammunition.

Moreover, Toyota is taking pains to develop local suppliers as it builds a factory in Britain. For its part, Nissan, which is introducing its first midsize car specifically designed for the European market and built in Britain, plans to expand its British output gradually. The two largest Japanese automotive manufacturers also do not expect their luxury car models (marketed here under the Lexus and Infiniti nameplates, respectively) to make much of a splash in the European market. Mitsubishi Motor Corp., however, plans to begin raising its visibility on the continent, ironically by exporting the Eclipse sports coupe from its American factory; it also is seeking a partner to build a production facility.

Investment Worries - The mixed reaction to onshore Japanese car production spotlights another area of controversy: foreign direct investment. Although the United States continues to grab the lion's share of Japanese foreign direct investment (see Table 5), the rate of expansion of Japanese investment flowing into Europe has outpaced that headed toward the United States in recent years. Europe's share of annual Japanese foreign direct investment rose from 15.8 percent in FY 1985 to 21.9 percent in FY 1989. The United Kingdom has benefited the most, easily attracting more Japanese investment than any continental country and accounting for more than one-third of Japan's cumulative investment in Europe. The second- and third-place rankings for the Netherlands and Luxembourg are deceptive, since most Japanese investment booked in these two countries ultimately ends up elsewhere in Europe. The surprisingly low Japanese stake in Germany and France is thought to result primarily from investor concerns since both countries are putting out more of a welcome mat for Japanese investors.

The EC's discouragement of screwdriver assembly plants, however, indicates a more discerning attitude toward foreign direct investment than that shown by Washington, although the debate in this country over the economic value of investment from abroad hardly can be called settled. European governments are interested in promoting foreign direct investment for employment gains, increasing value-added output, the inward transfer of technology and the development of local suppliers. In support of these reasons the EC has tried to impose

Table 5: Japan's Foreign Direct Investment by Country, FY 1985-FY 1989

(in millions of dollars)

	FY 1988			FY 1989			Cumulative March 31, 1990		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United Kingdom	211	$3,956	8.4%	285	$5,239	7.8%	1,864	$15,793	6.2%
Netherlands	105	2,359	5.0	112	4,547	6.7	642	10,072	4.0
Luxembourg	13	657	1.4	13	654	1.0	143	5,383	2.1
West Germany	67	409	0.9	119	1,083	1.6	1,053	3,448	1.4
France	148	463	1.0	168	1,136	1.7	1,157	2,899	1.1
Spain	32	161	0.3	58	501	0.7	277	1,546	0.6
Italy	26	108	0.2	47	314	0.5	255	684	0.3
Ireland	12	42	0.1	11	133	0.2	90	565	0.2
Portugal	4	7	0.0	10	74	0.1	44	114	0.0
Switzerland	27	454	1.0	19	397	0.6	288	1,829	0.7
Other Europe	47	500	1.1	74	730	1.1	656	2,639	1.0
Total Europe	692	9,116	19.4	916	14,808	21.9	6,469	44,972	17.7
United States	2,434	21,701	46.2	2,668	32,540	48.2	20,675	104,400	41.1
Hong Kong	335	1,662	3.5	335	1,898	2.8	3,499	8,066	3.2
China	171	296	0.6	126	438	0.6	694	2,472	1.0
Total	6,077	47,022	100.0	6,589	67,540	100.0	57,373	253,896	100.0

	FY 1985			FY 1986			FY 1987		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United Kingdom	85	$375	3.1%	142	$984	4.4%	178	$2,473	7.4%
Netherlands	38	613	5.0	60	651	2.9	71	829	2.5
Luxembourg	12	300	2.5	16	1,092	4.9	18	1,764	5.3
West Germany	48	172	1.4	59	210	0.9	50	403	1.2
France	60	67	0.5	52	152	0.7	99	330	1.0
Spain	8	91	0.7	15	86	0.4	24	283	0.8
Italy	11	32	0.3	18	23	0.1	26	59	0.2
Ireland	5	81	0.7	4	72	0.3	5	58	0.2
Portugal	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Switzerland	15	60	0.5	7	91	0.4	22	224	0.7
Other Europe	31	139	1.1	31	99	0.4	44	71	0.2
Total Europe	313	1,930	15.8	404	3,469	15.5	537	6,576	19.7
United States	921	5,395	44.2	1,232	10,165	45.5	1,816	14,704	44.1
Hong Kong	105	131	1.1	163	502	2.2	261	1,072	3.2
China	118	100	0.8	85	226	1.0	101	1,226	3.7
Total	2,613	12,217	100.0	3,196	22,320	100.0	4,584	33,364	100.0

Source: Ministry of Finance

certain requirements on foreign-owned production facilities, mainly via discriminatory tariffs. For example, integrated circuits that do not undergo the high value-added production steps (wafer fabrication) in the EC are considered imports even if assembly and testing are conducted locally. This has generated a burst of investment announcements by Japanese chipmakers.

The EC's stance toward acquisitions by Japanese firms within its boundaries can best be described as one of vague unease. Under pressure from domestic firms the community has put forth a streamlined approval system for crossborder takeover bids. Whether foreign bids will receive the same treatment as domestic ones has not been discussed explicitly. American companies have pressed Washington to obtain assurances from Brussels on this question and appear to have received a mollifying response. For EC countries with a significant share of government-owned companies, such as France, the question of Japanese mergers and acquisitions is particularly sensitive. Chastened by the backlash created by takeovers of high technology companies in the United States, Japanese investors have approached this European minefield with particular care.

One Japanese investment, in particular, focused European attention on the subject. Fujitsu, Ltd.'s November 1990 purchase of 80 percent of British computer giant International Computers Ltd. for almost $1.3 billion stunned the continent. ICL was Britain's only remaining mainframe computer maker and a respected force in the European computer market. The buyout followed eight years of friendly relations during which Fujitsu provided much of ICL's mainframe technology. The purchase put Fujitsu in a close race with Digital Equipment Corp. for the number-two spot in the global information services market. The acquisition also gave Japan's top computer maker an enlarged presence in the European computer market. It is not a commanding position, however, as ICL's share of the European market is about 1.8 percent, tiny compared to the shares held by such U.S. firms as International Business Machines Corp. (20.1 percent) and DEC (4.5 percent). ICL's management touted the capital infusion as the key to expanding sales. Other European computer makers and some British observers viewed the transaction as an unpatriotic sellout. The acquisition has since triggered a European debate on an even more sensitive topic: Japanese participation in joint European research projects.

Research Fears - As Britain's leading computer maker, ICL was a member of several EC-funded and private research consortia. The company was a founding member of Esprit, for example, a roundtable of 12 European computer makers formed in the late 1970s to promote joint research and development in information technologies. At the time Fujitsu purchased its controlling share of ICL the British firm was involved in nine Esprit programs. In early February 1991, however, the managing board of Esprit voted to expel ICL, saying that its membership was no longer consistent with the roundtable's purpose of enhancing the competitiveness of the European computer industry vis-a-vis the Japanese and the Americans. ICL was not, according to Esprit, a "truly European-owned company." Fujitsu expressed regret at the decision but promised it would work to retain ICL's membership in other European projects. Fujitsu also announced plans to build its own research facilities in Europe to add to those owned by ICL.

One of the more visible EC-funded R&D projects is the Joint European Submicron Silicon Initiative or JESSI. ICL participates in five JESSI projects. Unfortunately for ICL, many Esprit board members also sit on JESSI's steering committee. A debate is raging over whether ICL's ties to Fujitsu can somehow be turned to JESSI's advantage and whether EC funds should be used to support research by a Japanese-owned participant. ICL is hopeful that it will be allowed to remain in JESSI, pointing out that its involvement is more as a user of integrated circuits and that IBM's European subsidiary has been allowed to join two JESSI programs. A formal vote to expel ICL may be unnecessary because any EC-funded project must involve at least two partner firms. If ICL is unable to persuade another JESSI member to join in a program, it effectively may be barred from participation.

Another sensitive research project where the Japan question has surfaced in a different form involves development of the next generation of advanced televisions. Eureka, a joint research program started in 1985 aimed at developing commercial technologies (it oversees JESSI, for example), has put a high priority on a strong European presence in the market for high-definition television. Although Japan Broadcasting Corp. (NHK), a quasi-governmental company, had been working on HDTV since the 1960s, the Europeans managed to delay a 1986 vote on international standards that NHK had hoped to win. The Japanese firm had been ready to demonstrate its technology; its picture format and broadcast system already had been adopted as the future Japanese standard. The delayed vote of the global standards-setting body gave EC firms time to pool their resources to propose a different HDTV system. The United States since has weighed in with a third development effort and is about to begin a trial of several HDTV systems that are incompatible with both the Japanese and the European systems. (For a detailed discussion of the competition to develop advanced television, see JEI Report No. 2A, January 13, 1989.)

The EC continues to back Eureka's HDTV effort but may be foiled by unexpected developments. British, German and French television broadcasters are lukewarm about Eureka's system, arguing that it is too costly to install the necessary broadcast equipment. Resistance also has developed because the Eureka system is a transitional standard, not "true" HDTV. Promoters of the Eureka system ironically have turned to Japanese firms to help finance broadcast equipment installation in exchange for rights to produce the equipment. This would be a blow to France's Thomson SA, which has just brought to market a receiver compatible with the Eureka system. The $7,000 machine is considerably cheaper than what Japanese manufacturers are charging for their first-generation HDTV receivers.

The JESSI and Eureka research situations have brought the debate over Japanese participation to a boil, but a definitive answer has not yet floated to the top. Nevertheless, Japan and the EC have forged joint research ties in a number of important areas. For example, Britain's Rolls-Royce PLC and France's Snecma have agreed to participate along with United Technologies Corp. and General Electric Corp. in a Y5 billion ($37 million at Y135=$1.00) Japanese government-funded project to develop an engine for a Mach-5 aircraft. Along with the United States, the EC has responded with interest to a MITI proposal to develop standards for manufacturing technologies for future-generation products. Launching the Integrated Manufacturing System project has not been smooth (see JEI Report No. 37A, September 28, 1990) but does hold promise as a model for future cooperation.

Conclusion

It is clear that the emergence of Japan and the European Community as economic powers is forcing a reassessment of their bilateral relations. The

EC's 1992 economic integration plan poses huge challenges not only to the Europeans but to the Japanese as well. The implications and the effects of the 1992 plan cannot yet be fully predicted, if for no other reason than because many aspects of economic integration have yet to be completely worked out. At a minimum EC 1992 has underscored the woefully inadequate institutional framework for resolving bilateral disputes and has heightened the importance of developing such mechanisms. It also has highlighted the underdeveloped state of political relations between the two trading partners. Amicable settlement of relatively simple trade disputes has eluded the two sides, not boding well for the growing number of new, more difficult issues, such as direct investment policy and R&D policy. Bilateral relations probably will continue to exhibit a Jekyll and Hyde character for some time, as the two allies cooperate in some areas while battling each other furiously in others.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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Japanese Plant And Equipment Spending On Plateau

A series of recent Japanese surveys could cause a few nightmares among that nation's business leaders even though similar findings would cause few American managers to lose sleep. Operating profits as well as plant and equipment spending may have stopped rising after typically showing double-digit growth rates since Japan began pulling out of a recession in late 1986. The Bank of Japan's Short-Term Economic Survey of Enterprises, conducted in February and released March 6, showed that the 690 large firms polled planned to increase investment in plant and equipment a scant 1.1 percent on average in fiscal 1991, which begins April 1 (see Table). The results suggest a leveling off of capital spending, which rose 18 percent in FY 1989 and is expected to increase 15 percent in FY 1990.

BOJ's results are consistent with those of two other surveys, both of which also were conducted in February. A Nippon Credit Bank, Ltd. poll of 1,506 large and small companies showed that the firms on average planned to increase their plant and equipment spending only 2 percent in FY 1991. The results of a survey of 1,500 firms by Nihon Keizai Shimbun, the economic daily, revealed an expected 2.1 percent rise in FY 1991 business investment in contrast with the 15.5 percent jump anticipated this year.

None of the surveys purports to be a representative sample of all Japanese firms. Small businesses are underrepresented, if polled at all. As

Capital Spending Survey of Large Firms, FY 1990-FY 1991

(change from previous fiscal year)

	FY 1990 Estimated		FY 1991 Projected	
	Operating Profits	Capital Spending	Operating Profits	Capital Spending
Manufacturing				
Food Products	4.4%	-1.8%	0.8%	-9.6%
Textiles	-3.3	6.7	3.7	2.4
Paper and Pulp	-49.8	-1.6	7.4	-43.5
Chemicals	-8.3	11.6	1.9	0.7
Petroleum Products	42.6	31.1	1.9	0.8
Nonmetallic Mineral Manufactures	-15.3	33.3	3.1	2.7
Steel	-15.2	34.2	-14.0	6.3
Nonferrous Metals	2.8	34.7	1.4	5.4
Fabricated Metal Products	11.1	53.5	4.9	2.8
Nonelectric Machinery	8.9	44.9	2.1	-7.7
Electric Machinery	3.4	15.4	0.4	-2.3
Shipbuilding and Heavy Machinery	16.2	37.4	6.5	3.2
Motor Vehicles	1.1	30.3	-2.2	4.5
Precision Instruments	19.3	23.0	5.6	-6.0
Average Manufacturing	-0.3	21.2	-0.1	-1.1
Nonmanufacturing				
Construction	22.5	17.2	4.9	-7.7
Real Estate	7.2	18.6	0.9	-0.8
Trading Companies	3.3	8.5	4.5	-11.8
Retailing	6.2	8.2	5.2	10.3
Transportation and Communications	-2.4	11.1	0.7	4.7
Electric Power	n.a.	9.8	n.a.	3.5
Gas Supply	n.a.	7.5	n.a.	2.5
Electric Power and Gas Supply	-36.8	n.a.	-1.8	n.a.
Services	6.1	35.5	7.5	-12.1
Leasing	-30.7	21.4	-7.8	3.7
Average Nonmanufacturing	-1.7	13.9	2.9	2.7
Average All Industries	-0.8	16.9	1.0	1.1

Source: Bank of Japan

reports of intentions, moreover, the investment plans are subject to revision. In the past firms usually have ended up spending more than they initially predicted. Furthermore, companies probably were especially pessimistic in February while war was raging in the Middle East.

Corporate managers, however, still have reason to worry to the extent the surveys reflect their own firm's situation and that of their customers. The Nippon Credit Bank survey showed firms were more pessimistic than in the bank's July survey, when they had said they would spend 4.5 percent more in FY 1991. In addition, the results do not reflect the effects of inflation. An adjustment for recent price increases in plant and equipment would shave at least a percentage point off the reported figures. The somewhat unreliable data available for small- and medium-sized firms suggest that, if anything, they are less optimistic than their larger counterparts. These considerations point to a real possibility of essentially unchanged -- or even somwhat lower -- real capital spending in FY 1991.

As the table shows, profits also are close to a plateau. Smaller expected earnings imply that investment projects are less likely to pay off. For example, if existing products are less profitable than previously, planned new products are likely to generate lower earnings than initially expected. This presents the likelihood of delay or postponement of plant and equipment spending. Recently released consumer spending data for November through January, which showed increased caution on the part of Japanese consumers, may have been a factor in the investment and profit survey results; manufacturers, whose sales and profits reflect more the whims of consumers than do those of nonmanufacturers, were much less optimistic than their counterparts in other industries. Within the manufacturing sector highly cyclical industries like pulp and paper forecast particularly sharp declines in profits and expected investment. To the extent that the apparent weakness in Japanese consumer spending continues, investment plans could be revised downward, with cyclical industries scaling back the most.

If the survey results cause insomnia on one side of the Pacific, could they serve as a tranquilizer on the other? Such use would stem from a misreading of the data and a misdiagnosis of the American economic patient. The surveys suggest that Japan's plant and equipment spending will change little. That is cause for continuing concern among American business leaders worried about facing ever more competitive Japanese rivals, since profit and investment levels in Japan still will be high. During FY 1989 plant and equipment spending came to 18.7 percent of nominal gross national product in Japan, a figure nearly double the corresponding American figure. The survey results, if confirmed by actual experience, would imply little change on Japan's side in the relative size of private capital spending as compared to that of U.S. firms.

At the same time, the concern among some Americans about Japanese capital spending is overdrawn. High levels of plant and equipment investment in Japan may pose a threat to particular U.S. industries or companies that face more competitive Japanese rivals, but this may not necessarily impinge on the U.S. economy as a whole. The effect of more capital spending in Japan generally is to increase the productive capacity of that economy, with higher levels of imports as well as exports. In the current expansion managers typically have used plant and equipment spending for purposes other than that of boosting their own firm's potential output. For example, investment in labor-saving equipment has minimized bottlenecks in the economy created by a shortage of workers. In such situations exports are larger or smaller depending on how the higher real incomes generated by the expansion are spent or saved. For this and other reasons the United States could end up a winner from higher Japanese levels of plant and equipment spending. In other words, higher business investment in Japan could serve as a medicine for the U.S. economy, but one that has nasty side effects for some American industries. Current trends suggest that American firms should prepare to live with about the same-sized potion over the next 12 months.

Douglas Ostrom

Financial Reform Advances On Multiple Fronts

Although only a few months old, 1991 already is a milestone year for the financial systems of both the United States and Japan. History might record it as a watershed year as well. Both in Washington and Tokyo efforts are under way to restructure fundamental aspects of their respective postwar national financial systems. While the Bush administration has bundled together proposals that could lead to sweeping changes over the long term, the government of Prime Minister Toshiki Kaifu continues to follow its predecessors' incremental approach to financial liberalization. Nevertheless, the scope of Tokyo's effort is as broad as Washington's and already is influencing events in Japan's financial world.

Both the United States and Japan have been struggling for the past several years with a legacy of the Great Depression: laws that prevent banks and securities companies from entering each other's field of business. The Ministry of Finance gradually has been building a consensus between the banking and the securities industries to bridge the business barriers imposed by Article 65 of the Securities and Exchange Law, the Japanese counterpart to the Glass-Steagall Act of 1933. Two advisory councils -- the banking-affiliated Financial Systems Research Council and the brokerage industry's Securities and Exchange Council -- have submitted initial reform recommendations to MOF (see JEI Report No. 25B, June 29, 1990). After studying these reports the ministry has drawn up a list of proposed changes for discussion by both advisory bodies. MOF hopes that both councils will submit their final reports by the middle of this year, leaving officials time to incorporate the results of the studies in new legislation to be developed for submission to the next regular session of the Diet.

MOF's draft suggestions, released February 28, are less sweeping than major commercial banks and even the ministry originally had hoped. Rather than allow banks and brokers to go head-to-head via wholly owned subsidiaries in any market they wish, MOF's proposal limits competition to only a few markets. Commercial banks would gain permission to establish underwriting and trust bank subsidiaries, while stock brokers could start trust bank operations. Trust banks would be allowed to participate in the securities market, and nonbank financial institutions, such as leasing firms and consumer credit companies, could engage in foreign exchange dealing as well as accept deposits and settle financial obligations between clients and third parties.

As a sop to banks and brokers worried about the competitive threat posed by the other, the activities of the new, ground-breaking subsidiaries would be

STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1988	1989	January-December 1989	January-December 1990	October 1990	November 1990	December 1990
Japan's Balance of Payments							
Trade Balance	$95,012	$76,917	$76,917	$63,856*	$5,986*	$4,515*	$8,199*
Exports (f.o.b.)	259,765	269,570	269,570	280,177*	26,002*	25,008*	27,697*
Imports (f.o.b.)	164,753	192,653	192,653	216,321*	20,016*	20,493*	19,498*
Current Account Balance	79,631	57,157	57,157	35,792*	2,733*	1,749*	3,713*
Long-Term Capital (net)	-130,930	-89,246	-89,246	-43,455*	7,092*	-2,850*	-5,379*
Overall Balance	-28,982	-33,286	-33,286	-7,234	-471	5,901	-2,564
International Reserves (end of period)	97,662	84,895	84,895	77,053	76,190	76,672	77,053
Japan's Customs Clearance Trade							
Trade Balance	77,563	64,328	64,328	52,149	3,235	2,247	5,437
Exports (f.o.b.)	264,917	275,175	275,175	286,948	26,725	25,743	28,366
Cars	38,671	38,804	38,804	41,362*	3,750	3,763	3,922*
Steel	15,322	14,789	14,789	12,513*	1,149	1,034	1,339*
Imports (c.i.f.)	187,354	210,847	210,847	234,799	23,491	23,496	22,929
Crude Oil	18,852	21,544	21,544	31,559*	3,628	4,569	5,045*
Manufactured Products	91,838	106,111	106,111	118,028*	11,703	10,940	10,325*
Japan-U.S. Trade							
Trade Balance	47,597	44,943	44,943	38,025*	3,723	3,563	3,486*
Exports (f.o.b.)	89,634	93,189	93,189	90,312*	8,466	8,082	8,221*
Imports (c.i.f.)	42,037	48,246	48,246	52,287*	4,744	4,519	4,735*
Yen-Dollar Exchange Rate (average for period)	Y128.15	Y137.96	Y137.96	Y144.79	Y129.73	Y129.08	Y133.55
U.S. Trade							
Trade Balance	-118,526	-109,399	-109,399	-100,997*	-12,805	-9,996	-6,217*
Exports (f.a.s.)	322,426	363,812	363,812	394,045*	35,296	33,689	33,074*
Imports (Customs)	440,952	473,211	473,211	495,042*	48,101	43,685	39,291*
U.S.-Japan Trade							
Trade Balance	-51,793	-49,059	-49,059	-41,071*	-4,453	-3,788	-3,439*
Exports (f.a.s.)	37,725	44,494	44,494	48,585*	4,250	4,351	4,371*
Imports (Customs)	89,518	93,553	93,553	89,655*	8,703	8,139	7,810*

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1988	1989	January-December 1989	January-December 1990	October 1990	November 1990	December 1990
Discount Rate (end of period)	2.5%	4.25%	4.25%	6.0%	6.0%	6.0%	6.0%
Outstanding Money Supply	11.2%	9.9%	9.9%	11.7%	11.8%	9.9%	8.5%
Industrial Production	9.5%	6.1%	6.1%	4.6%	8.2%	6.8%	6.0%
Manufacturing Operating Rate	5.9%	2.2%	2.2%	2.3%	5.5%	3.7%	3.3%
Number of Bankruptcies	-20.0%	-28.5%	-28.5%	-10.6%	9.7%	23.2%	44.8%
Residential Construction Starts	0.6%	-1.3%	-1.3%	2.7%	0.7%	-3.7%	-1.4%
Job Openings to Applications (ratio)	1.01	1.26	1.26	1.40	1.42	1.41	1.43
Nominal Wages	3.8%	4.7%	4.7%	5.1%	4.7%	4.2%	6.1%
Manufacturing Labor Productivity	11.5%	6.2%	7.1%*	3.7%*	6.5%	n.a.	n.a.
Wholesale Prices	-1.0%	2.5%	2.5%	2.1%	1.5%	2.0%	2.2%
Consumer Prices	0.7%	2.3%	2.3%	3.1%	3.5%	4.2%	3.8%
Yen-Based Export Prices	-2.2%	4.4%	4.4%	2.2%	-4.0%	-4.8%	-3.2%
Yen-Based Import Prices	-4.6%	7.7%	7.7%	8.7%	9.7%	10.5%	11.5%

*Through October of each year only.

For Japan's latest GNP figures, see JEI Report No. 47B, December 14, 1990.

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JEI

REPORT

A Two-Part Report: A and B

NO. 11A March 22, 1991

FY 1991 OUTLOOK FOR THE JAPANESE ECONOMY

Summary

The past year has imposed a number of obstacles to the continued growth of the Japanese economy. Higher interest rates at home and the threat of recession abroad head the list. While the economy appeared to slump in the last part of calendar 1990, only the coming months will reveal whether the apparent slowdown was a response to concerns posed by the Persian Gulf crisis, namely the price of oil and the likelihood of sustained international conflict.

With their economies interrelated in many ways, the United States ignores the state of the Japanese economy at its own peril. Since fiscal 1986 the Japanese economy has grown rapidly, pulling in more imports. In spite of this good macroeconomic performance, trade frictions have risen. Should the Japanese economy falter, relations could worsen further. Partly for this reason, the next 12 months promise to be an interesting, if not necessarily enjoyable, time for policymakers in Washington and Tokyo. The best guess is that Japan's economy will continue to grow, albeit at a somewhat slower pace than in FY 1990.

Japan's Economy in FY 1990

From all appearances the fiscal year that began April 1, 1990 had all the makings of a disaster. The stock market began a free fall in January 1990 that continued into the spring of last year. Many Japanese analysts -- in some contrast to their American counterparts -- argued that the market soon would recover. They were to be proven wrong fairly quickly. Iraq's August invasion of Kuwait sent the market into a deeper downward spiral and pushed up oil prices, one of the traditional banes of the Japanese economy. Moreover, rising interest rates over the spring and the summer aggravated investors' concerns. The higher rates also threatened to choke off plant and equipment spending, one of the main engines of Japanese economic growth in recent years.

In addition, the economy was buffeted by disquieting foreign economic forces. By all accounts the United States, Japan's largest foreign market, entered a recession in late 1990. Coupled with slower growth elsewhere overseas, the U.S. economic downturn threatened Japan's exports as well as the profits of companies that count on the American market for a significant part of their sales.

As FY 1990 draws to a close some of the negative indicators have reversed course. Oil prices, for example, have dropped to their preinvasion level. Some American experts see signs of life in the U.S. economy. The Japanese stock market, although still far below the peak achieved on the last trading day of 1989, by mid-March had regained more than two-thirds of its lost ground. While short-term interest rates continued to edge upward, long-term rates began falling in September and, by the end of February, were lower than a year earlier.

Assuming that long- and short-term interest rates do not turn sharply upward and that the other factors do not similarly reverse themselves, the relevant question is whether the threats to the economy suggested by these indicators have played themselves out. Perhaps they may prove to be less dangerous than many experts believed or, alternatively, they may remain potentially menacing until defused.

Stock prices probably are in the former category. A falling equities market, by itself, does not pull the economy down, although it may hurt interest-sensitive parts of the economy to the extent that sagging stock prices are tied to higher interest rates. For example, if publicly traded firms have trouble selling new shares, they may have to pay more for funds; that could lead to a reduction in plant and equipment spending, which boosts both aggregate demand and aggregate supply in the Japanese economy. But issuing stock is not the only way companies can raise money; they can borrow, use retained earnings or other sources of cash flow or float bonds. The rate of return on these funds may or may not move in tandem with the yields on stocks. In short, most observers believe that the ups and downs of the stock market have a limited effect on the real economy.

Oil prices, another source of concern to analysts, now appear very unlikely to harm the Japanese economy. Many Japanese experts believe that, even during the 1973-74 and the 1979 oil shocks, high oil prices and shortages per se did little damage to the economy. (For details of this argument, see JEI Report No. 33A, August 24, 1990.) In the aftermath of Iraq's invasion of Kuwait prices did not rise as much -- or stay high for as long -- as during the two oil shocks of the 1970s.

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Interest rates -- which still are high by historical standards -- remain a question mark. Some American and Japanese analysts argue that large Japanese companies are virtually immune to higher interest rates because they can tap internal sources of funds for capital spending, but this view is incorrect. Toyota Motor Corp. sometimes is referred to as the "Toyota Bank" because it appears to be flush with cash, but when Toyota's vast subsidiary network is included, Toyota is a net borrower. Even if it were not, higher interest rates on bonds and other fixed-income securities alert investors to seek higher returns on all their investments, including equities. Hence, to satisfy stockholders even a cash-rich firm may well have to earn higher rates of return on its investment projects in the face of steeper interest rates.

These factors imply a decrease in the number of projects able to achieve sufficiently profitable returns. Hence, higher interest rates are likely to lead to reduced plant and equipment spending, even by firms with abundant cash. The role of Japanese households as net savers provides a partial counterbalance to the negative impact of higher interest rates on business investment. As interest rates rise, real incomes increase from the higher interest earned, other factors equal. As a result, consumer spending tends to rise. Even for households, however, interest-sensitive spending, such as home purchases, generally falls in the face of high interest rates.

On balance, higher interest rates will decrease aggregate Japanese demand, slowing the pace of economic activity. Rates would not necessarily have to go higher than the level they reached last summer, for example, to have an effect on the economy; the die already may have been cast. Plant and equipment spending plans, for example, are made months before investments are undertaken; actual spending, in turn, is reflected in official statistics with a one- to three-month lag. In short, weak business investment in the coming fiscal year may result from the level of interest rates in FY 1990, which, by some measures, were at their highest point in more than five years.

Government's FY 1990 Outlook in Review

In the closing days of 1989 the government prepared its outlook for FY 1990. The gross national product was expected to grow 4 percent after adjustment for price increases. If realized, this would have represented a modest slowdown from the 4.6 percent expansion the government then expected for FY 1989. (Actual real GNP growth in FY 1989 was 4.8 percent.) The government projected that plant and equipment spending in real terms would slow significantly to 7.3 percent, while consumer spending was predicted to pick up, rising 4.6 percent. Net exports adjusted for inflation were expected to be a drag on the economy again, as they had been in FY 1988 and would prove to be in FY 1989.

Private forecasters, who announced their figures at about the same time as the government, made similar, if somewhat more bullish, estimates. On average they expected real FY 1990 growth to equal 4.4 percent. At 9.3 percent, the forecast for business investment was higher than that made by the government, but the 4.5 percent advance estimated for consumer spending was slightly below the government outlook. Business analysts generally agreed that the foreign sector would pull down the overall growth rate.

The results now expected for FY 1990 suggest that the consensus private forecast was more accurate than the government outlook, although both projections are proving to be too pessimistic. Furthermore, the structure of growth appears more closely to match the average business prediction. Private forecasters on average also had a better record concerning FY 1989's GNP expansion and the components of growth (see JEI Report No. 8A, February 23, 1990).

From among the 39 private forecasters surveyed last year, a clear winner has emerged. Assuming the government's revised FY 1990 outlook of 5.2 percent real growth is correct, Sumitomo Trust & Banking Co., Ltd. will be right on the money with its prediction made 14 months ago. Only it expected such rapid growth. The bank's pessimistic outlook concerning inflation was almost as far from the mainstream and just as accurate; it projected that consumer prices would rise 2.9 percent. As such, it was closer to the now expected rate of 3.1 percent than all but one other forecaster, Kansai Economic Research Center, which had penciled in a 3 percent rate. All the other organizations surveyed underestimated inflation.

Sumitomo Trust's exchange rate forecast also was notable since it projected the weakest yen of all 39 forecasters at Y145=$1.00. If, as now appears likely, the yen averages Y141 to the dollar for FY 1990, the bank also will be the only forecaster to be more pessimistic than the actual result; moreover, it will be closer to the April 1990-March average than the consensus figure of Y135.5=$1.00.

In short, the Sumitomo Trust argument a year ago suggested that the economy would grow faster and, thereby, experience greater inflationary problems and downward pressure on the exchange rate than other analysts, whether government or private, had anticipated. The private consensus, in turn, mimicked Sumitomo Trust's direction, albeit less dramatically, in comparison with the government outlook. In all these respects, the Sumitomo Trust forecast apparently has come out on top.

Outlook for FY 1991

Despite the less-than-pinpoint accuracy of its initial FY 1990 outlook, Tokyo is sticking with the same approach in its projections for FY 1991. In an outlook resembling that of a year ago (see Tables 1-3) real overall economic growth is expected to equal 3.8 percent, led by a 6.8 percent increase in plant and equipment spending. Once again, consumers -- whose spending is projected to increase 4.1 percent -- are given the role of picking up the slack created by increasingly sluggish capital spending. In sum, government economists envision a substantial drop-off from FY 1990's currently expected real GNP growth of 5.2 percent; however, in terms of expectations there is only a slight reduction from the initial FY 1990 forecast of 4 percent growth.

While the government's computers have spit out virtually the same numbers as a year ago, private-sector forecasters are in different territory. For example, they have abandoned their role as optimist vis-a-vis government analysts. For the first time in three years business analysts anticipate lower growth than the government does (see Table 4). For FY 1991 they expect real GNP growth to average 3.6 percent, with consumer spending rising 3.9 percent and capital spending up 6.3 percent.

Some perennial optimists, who have been rewarded with top marks for accuracy in recent years, are not leading the cheering section this time. Last year's champ is an example. Sumitomo Trust, while relatively upbeat, is now no

Table 1: Government's FY 1991 Outlook for Real Gross National Product

	Actual			Estimated	Projected
	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Real Gross National Product	4.9%	5.9%	4.8%	5.2%	3.8%
Consumer Spending	4.1	5.5	4.1	4.2	4.1
Residential Construction	26.3	4.8	0.7	8.4	-2.7
Private Capital Spending	8.6	16.6	14.1	11.7	6.8
Government Spending*	3.0	0.9	1.8	2.0	1.9

*Sum of govenment current expenditures, fixed investment and inventory investment.

Source: Economic Planning Agency

Table 2: Other Indicators

(change from previous year unless otherwise indicated)

	Actual			Estimated	Projected
	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Industrial Production	5.9%	8.9%	4.5%	5.5%	4.1%
Wholesale Prices	-2.0	-0.7	3.5	2.0	-0.1
Consumer Prices	0.5	0.8	2.9	3.1	2.4
Unemployment Rate (percent)	2.8	2.4	2.2	2.2	2.2
Yen-Dollar Exchange Rate	Y138.3	Y128.3	Y142.8	Y139.3	Y128.1

Source: Economic Planning Agency

Table 3: Japan's Balance of Payments

	Actual			Estimated	Projected
	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Dollars (billions)					
Current Account Surplus	$84.5	$77.3	$53.4	$32.0	$30.0
Trade Surplus	94.0	95.3	70.0	57.0	56.0
Exports	233.4	267.4	268.1	285.0	305.0
Imports	139.4	172.1	198.1	228.0	249.0
Yen (trillions)					
Current Account Surplus	Y11.7	Y9.9	Y7.6	Y4.5	Y3.8
Trade Surplus	13.0	12.2	10.0	7.9	7.2

Source: Economic Planning Agency

Table 4: Summary of Private Forecasts for FY 1991

(percent change unless otherwise indicated)

	Real GNP FY 1990	Real GNP FY 1991	Real Consumer Spending	Real Capital Spending	Consumer Prices	Current Account Surplus*	Y/$ Exchange Rate	Oil Prices ($/barrel)
Banks								
Bank of Yokohama, Ltd.	5.6%	3.9%	4.1%	6.6%	2.7%	$41.8	Y123.8	$22.0
Toyo Trust & Banking Co., Ltd.	5.8	3.9	3.8	6.7	2.4	43.8	133.0	23.0
Bank of Tokyo, Ltd.	5.0	3.8	4.1	7.5	2.8	36.2	125.0	24.5
Daiwa Bank, Ltd.	5.1	3.8	4.0	8.1	2.8	39.9	128.0	23.0
Mitsubishi Trust & Banking Corp.	5.1	3.8	3.9	7.2	2.9	36.0	128.0	22.8
Sumitomo Trust & Banking Co., Ltd.	5.2	3.8	4.6	6.3	3.2	28.1	131.8	24.0
Dai-Ichi Kangyo Bank, Ltd.	5.6	3.7	3.8	7.8	2.4	32.8	129.0	23.0
Mitsui Taiyo Kobe Bank, Ltd.	4.9	3.7	3.7	7.0	2.8	21.5	123.0	24.0
Mitsui Trust & Banking Co., Ltd.	5.1	3.7	3.8	7.1	2.6	27.8	125.0	27.0
Sumitomo Bank, Ltd.	5.4	3.6	3.8	6.8	2.0	39.7	125.0	21.0
Hokkaido Takushoku Bank, Ltd.	5.1	3.5	3.8	5.9	2.6	34.4	117.8	24.7
Industrial Bank of Japan, Ltd.	5.3	3.5	3.7	6.8	3.1	35.1	133.0	21.5
Mitsubishi Bank, Ltd.	5.3	3.5	3.6	7.0	3.0	30.4	125.0	24.5
Nippon Credit Bank, Ltd.**	4.7	3.5	3.7	6.4	2.1	25.1	137.5	25.5
Yasuda Trust & Banking Co., Ltd.	5.1	3.5	3.8	5.7	2.8	40.0	123.0	20.0
Chuo Trust & Banking Co., Ltd.	5.0	3.4	3.9	6.7	2.6	28.4	129.5	23.2
Fuji Bank, Ltd.	5.1	3.3	3.9	5.8	1.7	16.0	130.0	25.0
Tokai Bank, Ltd.	5.0	3.0	4.0	5.3	2.0	31.0	107.5	25.0
Insurance Companies								
Meiji Mutual Life Insurance Co.	5.1	3.9	3.8	6.8	2.3	30.5	125.0	22.0
Tokio Marine & Fire Insurance Co., Ltd.	5.3	3.9	4.2	6.7	2.6	32.5	129.0	22.0
Asahi Mutual Life Insurance Co.	5.3	3.8	3.8	7.2	2.8	28.6	131.8	24.3
Dai-Ichi Mutual Life Insurance Co.	4.8	3.8	3.2	5.3	2.9	27.9	132.5	22.5
Sumitomo Life Insurance Co.	5.3	3.7	3.8	5.8	2.8	39.0	129.0	23.0
Trading Companies								
Mitsubishi Corp.	5.1	3.5	3.7	6.5	2.5	36.0	130.0	23.0
Marubeni Corp.	4.9	3.4	4.3	5.5	2.5	33.0	135.0	25.0
Sumitomo Corp.	5.2	3.4	3.7	5.1	3.0	31.2	125.0	27.0
Research Organizations								
Research Institute of the National Economy	5.3	4.2	4.6	7.8	2.7	43.2	126.5	22.0
Daiwa Institute of Research	5.2	4.0	4.2	5.9	2.5	38.0	125.0	22.2
Cosmo Securities Economic Research Institute	5.4	3.8	3.9	6.5	0.8	42.0	131.5	22.0
Mitsui Research Institute	5.2	3.8	3.9	7.0	2.4	40.0	125.0	20.0
Okasan Economic Research Institute	5.3	3.8	4.4	6.7	3.0	33.5	126.3	23.0
Yamaichi Research Institute	5.3	3.7	3.9	5.4	2.6	36.9	127.0	25.0
Kansai Economic Research Center**	5.0	3.5	3.9	6.3	1.8	44.8	128.3	21.3
Nomura Research Institute	4.9	3.5	3.9	4.8	3.2	40.0	131.0	25.0
Sanyo Research Institute	5.3	3.5	4.1	4.4	2.7	34.4	131.3	19.8
Nikko Research Center	5.3	3.2	3.7	3.9	3.1	37.5	125.0	20.0
Kangyo Kakumaru Research Institute	5.2	3.4	3.5	6.5	2.1	34.9	132.0	23.0
Japan Economic Research Center	5.4	2.9	3.8	5.1	2.3	49.5	128.4	23.3
Mitsubishi Research Institute	5.0	2.9	3.6	4.9	2.3	38.3	127.0	21.7
Average Forecast	5.2	3.6	3.9	6.3	2.6	34.9	127.6	23.0

*In billions of dollars.
**Real data use 1980 as base. Other organizations use 1985 as base.

Source: Toyo Keizai Tokei Geppo

more so than the government, sharing its expectations of 3.8 percent inflation-adjusted growth. Unlike the government, however, the bank sees inflation accelerating, equaling 3.2 percent for consumer prices. Sumitomo Trust also remains willing to go out on the limb from which it saw last year's outcome so clearly. In evaluating the U.S. economy's prospects only one other company is as pessimistic. Mitsubishi Trust & Banking Corp., alone among the forecasters surveyed, shares Sumitomo Trust's belief that the American economy will show no growth at all in calendar 1991. The dim outlook for the U.S. economy explains a substantial portion of Sumitomo Trust's relative pessimism.

Mild optimism about the yen continues for FY 1991, as the business forecasters envision the currency to appreciate to an average level of Y127.6=$1.00. Tokai Bank, Ltd., one of Japan's 10 largest banks, leads the optimists, believing that the yen will average only Y107.5 to the dollar. Tokai's forecast implies a 31.2 percent appreciation over FY 1990's expected figure. By contrast, the government assumes for calculation purposes that the yen will average Y128.1=$1.00, but the figure is not a forecast, Tokyo stresses.

The reduction in the current account surplus during FY 1990 has surprised government and private forecasters alike. A drop to less than $40 billion is likely in FY 1990, more than $15 billion lower than the government or the business sector initially anticipated. The official outlook expects progress to continue in FY 1991, with the surplus equaling $30 billion. By contrast, private forecasters put the FY 1991 surplus at $34.9 billion, which could end up higher or lower than the still unknown actual result for FY 1990.

On balance, private forecasters are almost uniformly gloomier than the government about the prospects for the economy in the year starting April 1. By their reckoning, both the economy as a whole and its components will grow more slowly than Tokyo expects; inflation will be slightly higher and the current account surplus larger. Not surprisingly, the Japan Economic Research Center, whose prediction of 2.9 percent real growth is the lowest (along with Mitsubishi Research Institute's) of all forecasters, projects a current account surplus of $49.5 billion, the highest estimate. JERC's figures serve as a warning that substantially lower Japanese growth would be accompanied by smaller imports than otherwise, thereby widening the balance of payments surplus.

Factors Affecting the Forecasts for FY 1991

The government outlook for the year starting April 1 and virtually all the private forecasts for FY 1991 were made public in December 1990. The outcome of the Persian Gulf conflict, of course, was unknown, as was the resultant movement in oil prices between December and March. All the forecasts assumed oil prices above $20 a barrel in both FY 1990 and FY 1991. As of early March the figures for the current fiscal year appear reasonable; through January 1991 FY 1990 customs-clearance crude oil prices averaged $23.14 a barrel. With oil prices substantially below that level in recent months and expected to remain weak, however, the FY 1991 estimates may be too high. Nevertheless, prices still are not likely to drop dramatically. Customs-clearance oil prices averaged $16.67 a barrel in the April-July 1990 period -- i.e., for the part of FY 1990 before the invasion of Kuwait; given that Kuwait and Iraq, which in the past have pumped approximately 7 percent of the world's oil, are unlikely to ship any significant amount to world markets in FY 1991, prices in that low range would be unusual in the coming fiscal year.

Some Japanese analysts have suggested that the economy will get a boost from the lower prices that are now expected. Since many of these same analysts predicted that higher oil prices would hardly make a dent in the economy, this would seem to indicate a desire to have one's cake and eat it too. In a typical forecast Fuji Bank, Ltd. estimated that a $5 swing in FY 1991 oil prices would create a 0.2 percentage point difference in Japan's economic growth. (For details of other estimates of the effect of hypothetically higher oil prices on the economy, see JEI Report No. 3B, January 25, 1991.) Hence, growth rates may be 0.1 to 0.2 point higher in FY 1991 than the figures shown in Table 4 if current oil prices hold.

Another unanticipated development was the approximately $9 billion that Tokyo pledged to assist the multilateral forces in the gulf. The Diet gave final approval to the funds and the taxes to finance them in early March (see JEI Report No. 9B, March 8, 1991). The one-year hike in the petroleum tax and the corporate income tax, which is expected to raise Y690 billion ($5.1 billion at Y135=$1.00), will have at most a small adverse effect on economic growth.

The U.S. economy is another factor. In fiscal 1989 exports to the United States amounted to 3.2 percent of Japan's GNP. Even a severe U.S. recession, however, probably would not reduce that amount significantly; a 5 percent drop in shipments over the levels otherwise possible would appear to be the upper limit of the impact on exports of a serious downturn in the American economy. In such a case, simple arithmetic suggests a negative effect on the Japanese economy of under 0.2 percentage point. This repercussion could be larger if, as is likely, the dollar were to appreciate in response to diminished demand for imported goods and capital in this country. Japanese exporters, too, could be expected to adjust prices. A myriad of other factors also would come into play as a result of the hypothetical drop in U.S. demand, some amplifying the initial adverse effect on the Japanese economy and others reducing it. The conclusion: a serious recession in the United States would make a downturn in Japan (roughly speaking, growth under 3 percent) more likely but would be far from sufficient to ensure such a result.

Looming largest of all factors in the outlook for the economy is plant and equipment spending. Its importance is threefold. As a rapidly growing component of GNP in recent years, it has directly explained a high proportion of overall GNP growth. For example, in the 12 months ending September 30, 1990, the most recent yearlong period for which data are available, real plant and equipment spending accounted for 45.1 percent (2.3 percentage points) of the overall real growth rate of 5.1 percent. Linked to this first idea is that the importance of plant and equipment spending to the overall economy has been growing; between FY 1985 and FY 1989 it rose from 16.3 percent to 18.7 percent of nominal GNP. Third, such investment lays the foundation for future GNP growth, especially if, as surely will happen, Japan's labor force grows increasingly slowly and then contracts over the next 10 years. (For details, see JEI Report No. 46A, December 7, 1990.)

Given such importance, one argument concerning plant and equipment spending deserves serious consideration. As nominal interest rates reached low levels during the late 1980s, Japanese manufacturers may have recognized a temporary window of opportunity. If interest rates remained low, they may have reasoned, inflation eventually would gather force, making new capital spending more expensive and pushing up nominal interest rates. Faced with this emerging scenario, the Bank of Japan could opt to push up nominal (and real) interest rates to help thwart significant inflation. In short, business leaders may have figured that real interest rates in the 1986-89 period were abnormally and temporarily low. Either way, the implication for firms was clear: invest in plant and equipment and lock in the related interest charges before both prices and interest rates could go up.

The low interest rate era followed by a few years a related development: the reversal, beginning in 1984 and particularly after 1986, in the downward drift of plant and equipment spending as a percentage of GNP that had been characteristic of the 1970s. Between 1970 and 1979 the share of business investment in nominal GNP dropped from 21.1 percent to 14.8 percent; between 1979 and 1983 the figure showed no clear trend. As noted above, in recent years the figure has rebounded, almost returning to its 1970 level. (For details, see JEI Report No. 15A, April 14, 1989.)

The upward movement in interest rates over the last two years or so raises the question as to whether the 1970-79 downward trend in plant and equipment investment as a share of GNP will resume. More important, would capital spending be sharply lower in FY 1991 in response to what might prove to be its temporary inflation in the FY 1986-FY 1990 time frame? If this development is possible, then the relatively bearish government projections of plant and equipment spending in FY 1989 and FY 1990 are relevant. If the forecasters were right about the optimal level of the capital stock but wrong about the timing of the investment needed to bring it to that level, plant and equipment outlays, having been borrowed from future years for spending in FY 1989 and FY 1990, could be sharply lower in FY 1991. Like a bubble that expanded for longer than expected, business investment could collapse with worse consequences than anticipated.

On this score the outlook is not particularly reassuring. Recent surveys of plant and equipment spending show that firms are not planning significant increases in FY 1991. For example, a February 1991 Bank of Japan survey of 690 large firms, the central bank's initial poll of investment plans for FY 1991, showed that these companies plan to raise plant and equipment spending a measly 1.1 percent compared to an anticipated 16.9 percent jump in FY 1990 (see JEI Report No. 10B, March 15, 1991).

The same survey indicated that manufacturing firms plan to reduce fixed investment 1.1 percent from what they spent in the current fiscal year. While firms typically guess low at the time of the initial February survey compared with their responses after the fiscal year begins, this year's results represent the first time since the initial FY 1987 survey that manufacturers said they would cut capital spending. In 1987 and 1983, the only other occasions since 1980 when large firms said they would reduce plant and equipment investment, predictions ended up as fact. (A separate Bank of Japan survey of small- and medium-sized manufacturing firms revealed that they, too, plan to cut plant and equipment spending in FY 1991. However, similar forecasts by these businesses in the four previous years proved incorrect.)

The BOJ survey results and comparable ones from the Japan Development Bank and Nippon Credit Bank, Ltd. need to be viewed with caution. The selected firms are not necessarily bellwethers of the economy's direction; firms can and do change their decisions. Furthermore, the surveys were conducted during

February when the outcome of the gulf war was not known. However, while these factors may bias the forecasts downward, the figures are in nominal terms, suggesting an offsetting upward bias.

If plant and equipment spending should falter, what will pick up the slack? Based on size alone, the only alternative is consumer spending, which, at almost 60 percent of GNP, is nearly three times as large as business investment. Given this prospect, the next logical question is whether plant and equipment spending and consumer spending typically move together or separately.

Over time the two economic series have tended to move together, although consumer spending shows less year-to-year variation. In addition, as illustrated by the private forecasts summarized in Table 4, for any given time period higher estimates of plant and equipment spending are associated with higher consumer spending. For example, the Research Institute of the National Economy is among the most optimistic concerning both consumer spending, which it expects to rise 4.6 percent in FY 1991, and plant and equipment spending, which it sees as increasing 7.8 percent, well above the consensus forecast in both instances.

In short, plant and equipment spending bears close watching. Some evidence suggests that it could be riding for a fall; if so, it is likely to pull consumer spending below the levels now anticipated. Along with other, lesser factors, such as the state of the U.S. economy, these arguments suggest that a FY 1991 Japanese-style recession, in which unemployment rises and growth slows markedly but does not disappear, cannot be ruled out. However, these adverse developments remain only possibilities; the best guess is that lower-than-expected oil prices will lift growth slightly above the consensus forecast in Table 4.

Japan's FY 1991 Economy in an International Context

Another reason for worrying about private nonresidential investment is its major role in accommodating the ongoing reduction in Japan's current account surplus. Table 5 tells the story. As Japanese companies have gone on a spending spree for new factories and equipment, they have soaked up surplus savings from the household sector. Funds available for investment abroad, other factors equal, have declined. This, in turn, has reduced the supply of Japanese currency on foreign exchange markets, raising its value. The higher yen has lifted imports, lowered exports and led to a smaller current account surplus than otherwise would be the case.

Nomura Research Institute estimates that, if real plant and equipment spending rises the modest 4.8 percent that it forecasts for FY 1991, then the deficiency in corporate savings actually will decline in FY 1990 and FY 1991. Absent increases in the demand for funds elsewhere, more money will be available for investment overseas, suggesting an increased possibility that both the yen's appreciation and the downward trend in the current account will be reversed.

Table 6 shows the same phenomenon in a different way. Huge increases in business investment have been one of the major domestic factors in GNP growth over the FY 1987-FY 1990 period. As noted above, these outlays also have played a role in boosting the value of the yen, and this, in turn, has contributed to

Table 5: Investment-Savings Balance

(in trillions of yen)

	Actual			Estimated	Projected
	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Household Sector	Y28.9	Y25.1	Y40.6	Y36.2	Y35.0
Corporate Sector	-11.4	-15.4	-27.8	-26.5	-25.0
Public Sector	-3.6	2.0	1.2	2.0	0.0
Foreign Sector	-11.7	-9.9	-7.6	-7.7	-7.0
Financial Sector	-2.2	-1.8	-6.4	-4.0	-3.0

Notes: The figures for FY 1990 and FY 1991 are Nomura Research Institute estimates and projections.

A negative figure indicates that a sector is a net user of Japanese savings. Therefore, balance of payments surpluses correspond to negative figures in the table.

Source: Bank of Japan and Nomura Research Institute

Table 6: Components of Japan's Real Economic Growth

	Total Rate	Domestic		External Component
		Private	Public	
FY 1984	4.5%	3.4%	0.1%	0.9%
FY 1985	4.8	4.2	-0.3	0.9
FY 1986	2.9	2.9	0.9	-1.0
FY 1987	4.9	5.3	0.5	-0.9
FY 1988	5.9	6.9	0.2	-1.1
FY 1989	4.8	5.2	0.3	-0.6
FY 1990*	5.2	n.a.	n.a.	-0.3
FY 1991**	3.8	n.a.	n.a.	-0.2

*Calculated from the government's growth estimate.
**Calculated from the government outlook.

Source: Economic Planning Agency

net exports being a drag on the overall growth rate. For FY 1991 Table 6 uses the official outlook for investment spending of 6.8 percent instead of the less optimistic consensus private forecast of 6.3 percent. Among private forecasters those with lower estimates of investment spending typically also predict smaller drops in net exports in FY 1991. In short, if investment should be less buoyant than now expected, Japan's current account surplus could be higher than currently anticipated.

For U.S.-Japan relations this conclusion has obvious importance. It suggests that bilateral relations, while currently not particularly healthy, could worsen along with the Japanese economy. Washington could judge a larger

Japanese current account surplus as contributing to problems that overshadow the presumed benefits of its inevitable counterpart, an increased capital outflow from Japan.

Conclusion

FY 1991 may provide tentative answers to some intriguing questions. Was plant and equipment spending unusually high in response to unusually low interest rates in the FY 1986-FY 1989 period? If business investment should falter, will automatic market mechanisms make other kinds of spending more appealing, thereby picking up the slack? After five straight years in which the external sector pulled down the rate of economic growth, with corresponding decreases in its importance, could a full-fledged recession in the United States and Europe still matter enough to nudge the Japanese economy into a recession as well? Alternatively, has Tokyo invented the world's first perpetual motion machine that is little fazed even by what would appear to be major economic disturbances?

Some late 1990 and early 1991 data suggest that a slowdown may have begun or be imminent. For example, the leading economic indicators had stood below the boom-or-bust midpoint for four straight months through December, the latest month for which data are available. This period corresponds to one where higher oil prices and, possibly, a devastating war appeared to be in the offing. With those dangers safely past, at least for the foreseeable future, will the yellow warning symbols of the winter turn green with the spring? The answer to that question will be known in a few months, but more fundamental questions about the Japanese economy will remain. For Americans, who are more than spectators of the Japanese economic drama, the answers to those questions will provide insight about their own economy as well.

For further information, contact Douglas Ostrom.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 11B
March 22, 1991

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Diet Passes FY 1991 Budget Quickly, Quietly

The initial general account budget for FY 1991 sailed through the lower house of the Diet March 14, in complete contrast to the stormy voyages encountered by the budgets for the previous two fiscal years. Despite this quick action, the upper house is not expected to vote on the spending package before the April 1 start of the fiscal year. This delay will force the government to prepare a stopgap spending measure for the fifth year in a row.

The budget's speedy and smooth journey through the House of Representatives was partly an illusion. The ruling Liberal Democratic Party used its lower house majority to approve the budget, sweeping aside unanimous dissent from the opposition parties. A vote by the House of Councillors, however, might not come before April 13, because its legislative hopper is overflowing. The need for an upper house tally after April 13 is moot under Japan's constitution, which mandates implementation of spending measures 30 days after lower house approval irrespective of upper house action. For the interim the Ministry of Finance has prepared a Y5.5 trillion ($40.7 billion at Y135=$1.00) provisional budget, enough to fund government obligations for the first 12 days of April.

Unlike previous years controversial issues were handled before the lower house began its budget debate. Conflict over the 3 percent consumption tax implemented in April 1989 -- the main legislative hurdle to budget passage in the past two years -- was neutralized by talks that began last autumn between the LDP and the opposition parties. While no definitive compromise was hammered out, the two sides agreed not to raise the subject when the FY 1991 budget was considered. Opposition parties found that this issue no longer was of much importance to voters, and the LDP, which at one time had suffered at the polls from its association with the tax, certainly had no interest in rekindling such voter attention.

The dust also had settled over the Kaifu cabinet's controversial land tax reform package (see JEI Report No. 5B, February 8, 1991), removing another

Summary of General Account Outlays, FY 1990-FY 1991

(in billions of yen)

	Initial FY 1990	Initial FY 1991	Change
Discretionary Items			
Social Security	Y11,614.8	Y12,212.2	5.1%
Education and Science	5,112.9	5,394.4	5.5
Pensions	1,837.5	1,808.4	-1.6
Defense	4,159.3	4,287.0	3.1
Economic Cooperation	784.5	845.9	7.8
Public Works	6,148.0	6,521.5	6.1
Disaster Reconstruction	66.7	68.2	2.2
Small Business Measures	194.3	195.0	0.3
Food Control Programs	395.2	373.2	-5.6
Energy Measures	547.6	592.1	8.1
Other	4,162.2	4,355.3	4.6
Infrastructure Investment	0.0	135.0	100.0
Reserves	350.0	150.0	-57.1
Persian Gulf Contribution*	--	300.0	--
Subtotal	35,373.1	37,238.2	5.3
Nondiscretionary Items			
Transfers to Local Governments	15,275.1	15,974.9	4.6
Debt Service	14,288.6	15,834.3	10.8
Transfer of NTT Proceeds to Public Works	1,300.0	1,300.0	0.0
Subtotal	30,863.7	33,109.2	7.3
Total	66,236.8	70,347.4	6.2

*This amount actually was disbursed in FY 1990. As part of a compromise plan to ensure legislative approval of Japan's roughly $9 billion contribution, however, the government agreed to trim FY 1991 defense spending by Y100 billion and to use Y200 billion originally earmarked for reserves to help finance this assistance.

volatile subject from the lower house's debate agenda before the budget vote. The LDP offered enough reforms to placate opposition parties, which had championed the cause of those who wanted but could not afford to buy homes, but these changes were not broad enough to pose a serious deflationary threat to the overheated real estate market.

To a large extent the protracted and passionate fight over the Kaifu government's response to the Persian Gulf crisis substituted for the normally acrimonious budget debate. Since Y300 billion ($2.2 billion) of the FY 1991 spending package will help finance Japan's contribution to the multinational forces, one might have expected the opposition parties to fight strenuously against approval of the package. On the contrary, the compromise between the LDP and the opposition parties that ensured Diet approval of Japan's nearly $9 billion contribution for the multinational forces deployed to the Middle East protected the FY 1991 budget from controversy precisely because it was linked to the gulf package (see JEI Report No. 7B, February 22, 1991). All opposition parties (including the Democratic Socialist Party and Komeito, which had backed passage of the LDP plan for the extra assistance) were able to vote against the budget because they knew their nays would not prevent the spending plan from being implemented.

Details of the initial general account budget are mainly unchanged from the version approved by the cabinet in late December 1990. Total general account spending remains pegged at Y70.3 trillion-plus ($521.1 billion); funds allocated to most major spending categories also are unchanged (see Table). In line with the gulf funding compromise, defense spending was pared by Y100 billion ($740.7 million), while Y200 billion ($1.5 billion) was diverted from reserves, both part of a plan to free up funds for the roughly $9 billion contribution. Although it has not yet been submitted, the FY 1991 tax plan also has elements linked to the gulf funding compromise. The revenue measure will include the already approved one-year increase in the petroleum tax and a surcharge on corporate income taxes.

While the LDP may have gained easy passage for the FY 1991 budget, continuing domestic debate on Japan's role in the reconstruction of Persian Gulf nations and its role in the "new world order" proposed by President Bush surely will include supplemental budget requests by the government. The quick vote on the spending program for the upcoming fiscal year may be the exception rather than the rule in the next 12 months as potentially controversial measures wait in the wings.

Jon Choy

Japanese Savings Growth Slows To A Crawl In 1990

The tortoise won, as any preschooler could have told a skeptical financial analyst. The fabled result is similar to the conclusion that can be drawn from a survey of Japanese household financial assets in 1990. As the Japanese stock market slumped last year, people who had invested their savings in instruments with slow-but-steady performance characteristics came out ahead. While stock prices last year were 12 percent below their 1989 average, interest rates on savings accounts rose as much as 2 percentage points to generate yields above 7 percent on some types of instruments.

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JEI

REPORT

A Two-Part Report: A and B

NO. 12A

March 29, 1991

JAPAN-U.S. AID COOPERATION: THE PROSPECTS FOR COLLABORATION

Summary

At a time when the United States and Japan face difficulties in their bilateral relationship, cooperation on development assistance is seen as a promising prospect for a constructive alliance. Each nation potentially could benefit from the other's foreign aid experience; both aid programs have gaps their counterparts could help fill. Each government has emphasized the increasing importance of aid cooperation, which has led to dialogue on several levels and successful coordination of broad aid initiatives, at least in Washington's view.

Most observers concur that aid coordination at some level is a worthy goal, if for no other reason than to keep the programs of the two top aid donors from working at cross-purposes. Policymakers in both countries view aid cooperation as a means of leveraging the political and the humanitarian objectives of development assistance while serving as a positive element in bilateral relations. Americans, in particular, see cooperation as a way of channeling the strengths of both programs toward such specific ends as global environmental problems or creating commercial opportunities for U.S. firms.

Yet many experts believe that the potential for collaboration is much greater than what has been accomplished so far. They cite the diversity of the two countries' foreign aid programs as a particular roadblock to further cooperation. A successful aid alliance would require give-and-take from both sides in their approach to cooperation. The current reexamination by both Japan and the United States of their individual programs presents an opportunity for reevaluating goals. Domestic calls to restructure

U.S. foreign aid have intensified in recent years, and several proposals have been made with an eye toward Japan. Japan's recent replacement of the United States as the world's largest donor of official development assistance presents additional challenges to Tokyo and Washington as they consider changes in their aid programs as well as prospects for aid cooperation.

Overview of the Foreign Aid Programs of the United States and Japan

Since 1985 the United States and Japan have been the largest donors of official development assistance among the 18 nations participating in the Development Assistance Committee of the Organization for Economic Cooperation and Development. Japan edged the United States out of the top donor position in 1989 when it disbursed nearly $9 billion in grants and loans to developing countries and multilateral aid organizations in contrast to the United States' net foreign aid disbursements of $7.7 billion. In some respects both countries' ODA programs failed to meet the expectations of the DAC in 1989. Japan's concessional ODA (grants and loans at below-market rates with extended repayment terms) was lower than the standards recommended by the group. The United States was faulted for contributing the equivalent of just 0.15 percent of gross national product, well below the 1989 DAC average of 0.33. (Japan's ODA/GNP ratio was 0.32 in 1989.)

Yet the combined development assistance efforts of the United States and Japan are impressive. Together they contributed 32.8 percent of DAC and non-DAC development assistance during the 1988-89 period, the OECD committee calculated. While both countries, particularly the United States, face domestic pressures on their development assistance programs, the size of their economies seems certain to assure their dominant aid presence in the years ahead. Washington's budget for foreign assistance has remained relatively unchanged in recent years. Tokyo, however, is likely to continue to expand its aid in line with the fourth medium-term plan announced in June 1988. Under this program Japan projected an increase in its ODA commitments to more than $50 billion between 1988 and 1992. Although the Ministry of Foreign Affairs has cautioned that exchange rate changes may disrupt achievement of this goal, significant increases have been earmarked in recent budgets. The initial FY 1990 economic cooperation budget was up 7.8 percent, while 8 percent more has been penciled in for the fiscal year starting April 1.

Arguing for an Aid Alliance

Aid issues long have been part of the U.S.-Japan relationship at the policy level. Following World War II Washington appealed to many countries to take on greater aid responsibilities; Japan's foreign aid program has its roots in the postwar reparations made to countries in Southeast Asia. In the early 1980s foreign aid served as the centerpiece of Tokyo's response to allied pressures to expand Japan's burdensharing efforts. In his recent book on Japan's

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development assistance program, Robert Orr of Stanford University's Kyoto Center for Japanese Studies examined the myriad ways the United States continues to influence Japan's foreign aid policy.[1]

From Washington's View - Recently Washington has intensified its appeal to Japan and others to assume a greater share of global responsibilities and burdens. In testimony presenting the State Department's foreign affairs funding request for FY 1992, Secretary of State James Baker noted that the administration sees greater reliance on "creative responsibility sharing" with allies -- Japan in particular -- as one means of meeting the goals of U.S. international cooperation programs. The United States is looking to such partners as Japan to shoulder some of the financial burden of the Persian Gulf War, the transition of Eastern European countries to market economies, debt relief and investment initiatives in Latin America, Mr. Baker said. Both the Bush administration and Congress recognize that this country's federal budget deficit makes such efforts particularly important, he added.[2]

Ronald Roskens, administrator of the Agency for International Development, recently underscored this point as he outlined AID's proposals for improving development programs and implementation. The United States is moving toward closer collaboration and coordination with other donors and multilateral financial institutions and "will be joining with them in shaping basic policies guiding our common efforts, as well as sharing some of the costs involved," Mr. Roskens told a Senate Appropriations Committee panel reviewing foreign operations.[3] In addition to the initiatives cited by Mr. Baker American officials emphasize the U.S.-Japan policy coordination achieved in recent years in the Philippines, where the two countries are the largest contributors to the multibillion-dollar Multilateral Assistance Initiative coordinated by the World Bank, and in sub-Saharan Africa, where the United States successfully has encouraged Japan to assume a more active aid role at the same time this country launched the Development Fund for Africa.

From Japan's View - Beyond broad policy coordination, however, have been calls in both Japan and the United States for collaboration on foreign aid at the operational level, a situation seen by development experts as benefiting both the donors and the recipient countries. The Foreign Ministry's 1989 annual report on official development assistance noted that for Japan, "Cooperation with other donor countries or organizations can boost the benefits of its aid to a level that could not be achieved by its own efforts alone, particularly in fields and regions in which Japan's experience, knowledge, and human resources are limited." The report also stressed the importance of donor coordination in individual countries to avoid duplication.

[1] Robert M. Orr Jr., The Emergence of Japan's Foreign Aid Power (New York, N.Y.: Columbia University Press, 1990).

[2] Testimony of Secretary of State James Baker before the House Foreign Affairs Committee, February 6, 1991.

[3] Testimony of Ronald Roskens, administrator, Agency for International Development, before the Subcommittee on Foreign Operations, Senate Appropriations Committee, March 12, 1991.

Many analysts point to staffing and funding levels as two areas in which the American and the Japanese aid programs, respectively, could complement each other. Although the U.S. foreign aid program is facing budgetary constraints, this country is recognized as having a wealth of development assistance experience. In contrast, while Japan increased its ODA budget several-fold during the 1980s, staffing levels did not keep up with the growth, a situation recognized by the Foreign Ministry. In 1988 the number of personnel involved in Japan's aid program was roughly one-third the size of AID's staff. Some aid experts caution, however, that the size of the U.S. aid bureaucracy does not necessarily add to its effectiveness.

Yet a U.S.-Japan aid alliance based on American ideas and Japanese funds troubles Japanese aid officials. American as well as Japanese observers warn against any collaborative approach that might enable the United States to impose its aid system and priorities on Japan. The Foreign Ministry's 1989 ODA report pointed out, for example, that ". . . other donors may learn much from Japan's position as a non-Western nation and its experience as a former aid recipient." Many American aid officials and analysts acknowledge that while the United States has learned hard lessons in its 40-plus years of providing development assistance, it would be unwise for this country to assume it cannot learn from Japan, especially as the United States is beginning to reassess the thrust of its own foreign aid program.

From Recipient Nations' View - Some analysts believe that Japan's request-only development assistance policy and its calibrated approach to providing aid as recipients progress economically are more relevant than the U.S. strategy of advancing projects, which often are in line with broad development objectives. The request-only basis for giving aid requires recipients to propose projects for funding, a situation that some development officials believe is better fitted to developing nations' needs. Lori Forman, an aid expert who was closely involved in discussions aimed at improving U.S.-Japan aid collaboration, notes that the United States can gain from Japan's overall philosophy of economic cooperation. She feels this country particularly should take note of Tokyo's strategy of altering the mix of grants and concessional and nonconcessional loans as the aid recipient is increasingly able to stand on its feet as a trade and an investment partner.[4] Ms. Forman comments that aid coordination is key to ensuring that American programs are not undone by competing programs, particularly in Asia, where Japan has a major aid and investment presence.

Some in the aid community worry that the policy-oriented objectives of U.S. aid could be undermined by the request-based economic approach of Japan's foreign aid program. Some recipient countries reportedly would prefer to play donors against each other in hopes of maximizing development assistance. Cooperation by the donors might minimze these opportunities. Moreover, aid experts, including Mr. Orr, note that the United States and Japan need to be sensitive to recipient nations' worries that their interests could be overtaken by collaborative efforts. Such concerns underscore the need to work toward aid cooperation at the multilateral as well as the bilateral level.

Political Concerns - Analysts in Washington and elsewhere point to aid cooperation as a way to check fears that as Japan's assistance to developing nations grows so will its political influence in these countries. The Japanese see aid, however, as a burdensharing option, not just an economic opportunity. And diplomats in both countries often point out that an aid alliance based on common policies and objectives could provide a constructive element to a bilateral relationship made volatile by other issues.

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[4] Interview with Lori Forman, February 20, 1991.

Yet despite the many strategic interests shared by the United States and Japan and the apparent agreement on initiatives at a broad policy level, many aid officials in both countries have expressed frustration with collaborative efforts at the operational level. Julia Chang Bloch, the former assistant administrator of AID's Bureau for Asia and Near East, has concluded, "As the 1990s begin, U.S.-Japan aid appears stalled between conflict and cooperation: while conflict has not gotten out of hand, cooperation has taken one step backward for every step forward."[5]

Cooperation Initiatives

U.S.-Japan cooperation on aid has been addressed in consultations that have run the gamut, from discussions on overall program goals to talks on specific project collaboration. Impressions about the effectiveness of both also run the gamut.

Consultations - U.S. coordination efforts with Japan are many and varied, taking place at all levels of the Department of State and the Agency for International Development as well as in discussions at the OECD, the OECD's Development Assistance Committee and other multilateral groups, according to AID's Assistant Administrator for Asia and Private Enterprise, Henrietta Holsman Fore.[6] DAC discussions, aimed at coordinating development assistance policies, have provided a forum for the United States and Japan to discuss such problematic issues as tied aid.

Consultations between the administrator of AID and the director general of the Ministry of Foreign Affairs' Economic Cooperation Bureau in 1978 in Shimoda, Japan were a precursor to fairly regular meetings at this level since then. In 1985 President Reagan and then Prime Minister Yasuhiro Nakasone concluded that the State Department's undersecretary for political affairs and one of Japan's deputy foreign ministers should meet annually to concentrate on the strategic aspects of aid. In the policy discussions that followed the United States urged Japan to increase its aid to countries beyond Asia, particularly to sub-Saharan Africa and to countries of strategic importance to the alliance, such as the Middle East. Japan's practice of mixing aid with export credits to win commercial contracts in Third World countries also was targeted during these meetings. (Limits on this practice eventually were set by the OECD.)

[5] Julia Chang Bloch, "A U.S.-Japan Aid Alliance?" in Shafiqul Islam (ed.), Yen for Development: Japanese Foreign Aid and the Politics of Burden-Sharing (New York, N.Y.: Council on Foreign Relations Press, 1991), p. 86.

[6] Prepared statement of Henrietta Holsman Fore, assistant administrator, Bureau for Asia and Private Enterprise, Agency for International Development, before the Subcommittee on Asian and Pacific Affairs, House Committee on Foreign Affairs, March 6, 1991, p. 5.

In May 1988 American and Japanese aid officials held an unofficial meeting in Honolulu to examine development issues affecting Asia as well as to gain a greater understanding of the programs run by both countries and to discuss possible areas for increased collaboration or cooperation. According to one AID official, the meeting was significant for three main reasons: it largely sidestepped policy issues and concentrated on the problems of designing and implementing aid programs; it focused the discussion on three Asian countries (the Philippines, Indonesia and India); and it brought together both field staff and aid policy officials from Washington and Tokyo.[7] Two more Honolulu meetings followed, a second coordinating meeting in October 1989 and informal consultations in January of this year.

The United States and Japan also have agreed to work toward greater cooperation between each nation's private sector in development assistance initiatives. In 1989 AID and Japan's Overseas Economic Cooperation Fund, which administers the country's concessional lending program, conducted conferences in California and Florida to explore ways American businesses could win a larger share of the contracts funded by Japanese foreign aid. The Department of Commerce, working with AID and the Environmental Protection Agency, is proposing a similar conference that would bring American firms with expertise in the environmental area to Tokyo to explore the commercial opportunities presented by Japan's foreign aid program.

Despite these consultations, Ms. Bloch is not alone among aid experts in describing cooperative efforts as lagging rather than gaining momentum. American observers note that although positive steps were taken in the first two Honolulu meetings, these extensive consultations were not used as the basis for the third session. They point to changes in AID's structure, personnel and, to some degree, its priorities as hampering significant progress. Japanese aid officials also reportedly are discouraged by the lack of continuity at recent meetings, although they, too, have been blamed for approaching the consultations with narrow expectations of what could and should be accomplished through aid coordination.

Joint Projects - Although recent U.S.-Japan aid discussions have focused on planning complementary programs rather than jointly administered specific projects, cooperation at the project level also has been a constant goal of both sides in aid consultations over the years. Several joint projects have been initiated between AID and the Japan International Cooperation Agency, which is responsible for implementing Japan's grant assistance. In one long-term collaborative effort involving an institute of postgraduate studies in agriculture in Bangladesh, JICA provided infrastructure and training while AID contributed technical experts. The two agencies similarly have divided responsibilities for an agricultural development research center in Thailand. Other joint projects between JICA and AID include: a family planning project in Bangladesh; an agricultural development project in Zaire; an ongoing education program in Western Samoa involving Peace Corps and JICA volunteers; and a center for Cambodian refugees in the Philippines, completed in 1982. JICA also joined OECF in working with AID on an agricultural development project in Indonesia.

[7] Norman Nicholson, chief of Planning and Analysis, Asia and Near East Bureau, Agency for International Development, in C.D.A. Ragonese (ed.) Japan's Overseas Development Assistance: Three Perspectives (Washington, D.C.: U.S. National Committee for Pacific Economic Cooperation, 1989), p. 1.

Some aid experts believe collaborating on specific projects is more feasible than harmonizing longer range development plans, but both Japanese and American aid officials have expressed frustration with this approach as well. Joint projects are complicated by different funding cycles, the contrast between Japan's emphasis on providing economic infrastructure and the U.S. focus on extending technical assistance, and the different ways the programs are implemented. Joint financing, which intermingles the donors' funds, increases the difficulties of oversight and management and is seen as more effectively accomplished by multilateral institutions than bilateral initiatives.

Because of the complications inherent in attempting to administer and finance projects jointly, there has been a greater reliance on parallel programming and financing. A parallel approach designates separate portions of a project for each donor and allows for discrete loan agreements and procurement practices. AID and OECF recently have coordinated a small-scale irrigation project in Indonesia and a health technologies project in India using parallel financing. The two agencies reportedly are discussing new possibilities for this approach. Other such efforts by the United States and Japan include a higher education support project in Indonesia.

Yet U.S.-Japan cooperation on a specific project basis still remains the exception rather than the rule. Another route more frequently followed is for Japan to adopt a project after U.S. funding is exhausted, an approach reportedly welcomed by both the United States and recipient countries. In Bangladesh, for example, Japan has taken on some of the funding for a rural electrification program originally financed through AID.

Key Problems -- Key Differences

Some aid experts say that the United States has sent mixed signals about its intentions and commitment to aid collaboration. Ms. Forman, a former AID official, notes that the issue of collaboration has never had a high enough priority to maintain a consistent focus. The Kyoto Center's Mr. Orr, while suggesting that there appears to be a "shift in thinking as to whether joint aid projects are appropriate," adds that there is "insufficient leadership in the U.S. government on cooperative aid-giving."[8] Both Ms. Forman and Mr. Orr cite the lack of consistency from the American side as a major stumbling block.

One problem appears to be the divergent approaches taken by the United States and Japan toward aid collaboration. Development experts note that in recent consultations AID has tended to focus on the policy objectives achievable through collaboration, while Japan's OECF is more eager to tackle the specifics involved in initiating projects. Having cross-purposes, it appears, has been a significant factor in the failure of the United States and Japan to move ahead with aid coordination. Moreover, some aid analysts caution that collaboration will be difficult unless the two countries address problematic differences in their programs.

Underlying many of the difficulties that emerged during the Hawaii consultations are divisions between the American and the Japanese approaches to aid. Among the key differences that aid experts suggest hinder collaboration

[8] Japan Economic Survey, XV, No. 3, March 1991, p. 10.

are: philosophies; objectives and priorities; regional focus; and implementation style. These elements are largely interwoven, which tends to reinforce some of the differences of the two programs.

Although both countries' foreign aid programs were launched after World War II, the U.S. program initially was aimed at reconstruction, while postwar reparations to Southeast Asia formed the roots of Japanese aid efforts. Despite subsequent changes in both programs, one of the sharpest contrasts to emerge is the U.S. emphasis on strategic interests and Japan's traditional stress on commercial concerns. These distinct motivating forces, in turn, have spurred other differences.

The diverse priorities of the Japanese and the American aid programs are reflected in the major recipients of their aid (see Table 1). For more than a decade the bulk of U.S. foreign aid has been directed to the Middle East, while American assistance to Asia gradually has declined. Although Tokyo has responded to international calls to expand the regional scope of its ODA, most aid continues to be directed to Asia, with bilateral assistance there still representing 62.5 percent of the total in 1989. Tokyo acknowledges that because of close economic, historical and geographic ties to Asia, Japan's foreign aid program is likely to continue to focus on this region. This same attention, however, points to another problem in meshing U.S.-Japan aid programs: the economic hue of Tokyo's aid program has enabled expanded Japanese trade and investment in Asia. Some U.S. firms have complained that this approach to aid comes at their expense.

In line with its philosophy of trying to help developing countries achieve economic self-sufficiency, Japan traditionally has focused on improving the economic infrastructure of recipient nations. The American aid program began to move away from capital projects and toward an emphasis on "basic human needs" in the early 1970s. Although Japan followed the United States in adding social and administrative infrastructure to its aid objectives, the share of Japanese foreign aid devoted to economic infrastructure still far outweighs that provided by the United States (see Table 2). Moreover, while military aid long has represented a significant portion of the American program, it remains outside the bounds of Japanese foreign assistance. Only recently has Tokyo cautiously proposed linking aid openly to strategic interests. Beyond responding to Washington's requests to increase aid to such areas of strategic importance as the Middle East, the Foreign Ministry's 1990 ODA report suggests that Japan may want to tie its foreign aid policy more directly to values of freedom and democracy.

The commercial opportunities provided by Japan's approach to development assistance have fueled numerous debates over the quality of Japanese ODA. Since the 1970s the United States has promoted a clear separation of trade promotion and foreign assistance, both in this country's aid efforts and in other donors' programs. In particular, the United States and other donors have urged Japan to reduce its tied aid, which requires aid recipients to purchase goods and services from the donor country. Although Washington also requires that part of its assistance be used to purchase American goods and services, analysts point out that the nature and the regional focus of U.S. foreign aid provide far fewer market opportunities than other donors' programs. Moreover, in contrast to programs geared to basic human needs, economic infrastructure projects such as those favored by Japan involve high value-added exports, including equipment

Table 1: Major Recipients of ODA, 1988/1989

(percent of total ODA by donor country; gross disbursements)

Japan		United States		All DAC Countries	
Indonesia	13.1%	Israel	12.5%	Indonesia	4.1%
China	7.4	Egypt	9.5	Egypt	3.1
Philippines	5.4	Pakistan	3.9	India	2.8
Thailand	4.9	El Salvador	3.3	China	2.8
Bangladesh	3.9	India	1.9	Israel	2.6
India	3.1	Philippines	1.8	Pakistan	2.1
Pakistan	2.8	Pacific Islands	1.6	Bangladesh	2.0
South Korea**	2.2	Guatemala	1.5	Philippines	1.7
Sri Lanka	2.0	Bangladesh	1.4	Tanzania	1.5
Burma (Myanmar)	1.8	Honduras	1.4	Thailand	1.3
Malaysia	1.5	Costa Rica	1.4	Mozambique	1.3
Kenya	1.5	Sudan	1.1	Kenya	1.3
Egypt	1.4	Morocco	1.0	Reunion	1.2
Turkey	1.2	Jamaica	1.0	Martinique	1.0
Nigeria	1.1	Indonesia	0.9	Turkey	1.0
Brazil	1.1	Bolivia	0.8	Ethiopia	1.0
Zambia	0.9	Jordan	0.7	Sudan	0.9
Tanzania	0.8	Dominican Republic	0.7	Senegal	0.9
Ghana	0.8	Peru	0.6	Sri Lanka	0.9
Syria	0.8	Kenya	0.6	Zaire	0.9
Nepal	0.7	Haiti	0.6	Morocco	0.9
Paraguay	0.7	Zaire	0.6	El Salvador	0.7
Bolivia	0.6	Sri Lanka	0.5	Zambia	0.7
Senegal	0.6	Tunisia	0.5	Polynesia, French	0.6
Subtotal	60.4	Subtotal	49.6	Subtotal	37.5
Multilateral	24.0	Multilateral	21.7	Multilateral	27.0
Unallocated	4.8	Unallocated	18.8	Unallocated	11.8
Total ODA*	$10,192	Total ODA*	$9,659	Total ODA*	$50,715

*In millions of dollars.
**The source listed below incorrectly cites North and South Korea.

Source: Organization for Economic Cooperation and Development, Development Co-operation: 1990 Report.

and machinery. In addition, a donor's market presence in the recipient country is reinforced through the maintenance of capital projects.

In recent years Tokyo has made significant progress in untying its ODA loans; 80.5 percent of all ODA loans were untied in 1989, compared to an average 53.9 percent in the four-year period between 1984 and 1987. Many critics contend, however, that the structure of Tokyo's aid program results in more contracts for Japanese businesses than these figures reveal. For example, the request-only policy of Japanese ODA frequently results in the work being awarded to Japanese companies that often have assisted in shaping the project.

Table 2: Major Uses of ODA, 1989

(percent of total ODA by donor country; based on commitments)

	Japan	United States*	All DAC Countries
Social and Administrative Infrastructure	17.5%	19.2%	25.7%
Education	5.8	44.6	10.7
Health and Population	2.6	7.2	6.7
Planning and Public Administration	0.8	2.1	1.6
Other (incl. water supply)	8.4	5.2	6.7
Economic Infrastructure	31.7	2.7	19.1
Transport and Communications	19.3	1.2	11.7
Energy	6.3	1.4	5.4
Other	6.0	--	2.0
Production	16.9	14.3	18.6
Agriculture	10.0	9.6	11.3
Industry, Mining and Construction	6.6	0.3	5.5
Trade, Banking and Tourism	0.3	4.3	1.7
Multisector	1.8	0.1	2.6
Program Assistance	20.6	22.5	12.4
Debt Relief	n.a.	2.1	--
Food Aid	0.6	19.0	5.9
Emergency Aid (other than food)	0.1	1.7	1.6
Administrative Expenses	3.4	5.8	4.0
Unspecified and Support to Private Voluntary Agencies	3.8	13.8	8.0
Total	100.0	100.0	100.0

*U.S. figures are for 1988.

Note: Military aid is not included in DAC's annual report on ODA performance.

Source: Organization for Economic Cooperation and Development, Development Co-operation: 1990 Report.

Another contrast between the two countries' programs that underscores their divergent aid philosophies is Japan's preference for providing loans over grants. Although Tokyo has acknowledged the need to increase grant aid, the share of grants in Japan's bilateral aid disbursements averaged 44.5 percent over the 1985-89 period and was a lower percentage in dollar terms in 1989 (44.8 percent) than in 1988 (45.3 percent). In comparison, nearly all U.S. foreign aid is provided as grants. Although the opposite would seem true, aid experts say both loans and large infrastructure projects require less oversight and administrative work than grants. That situation fits Japan's small, centralized aid bureaucracy. The U.S. aid program, in contrast, generally is decentralized, with significant authority resting with numerous staff in the field.

Prospects for More Effective Aid Cooperation

Several aid experts suggest that a more promising route to development assistance cooperation between the United States and Japan is to focus on a limited number of areas or issues. Former AID official Bloch recommends concentrating on areas where the complementarity of the two programs is most evident. While the United States could assist with development training for Japanese aid personnel and provide guidance for coordination with nongovernmental organizations and other development participants, for example, Japan could share its expertise on working with the private sector. Ms. Bloch adds that Japan also could gain from AID's experience in the areas of evaluation, monitoring and accountability systems; environment; food aid; and regional expertise in Africa and Latin America.[9]

Other aid experts also highlight the environment as a promising sector for aid coordination, particularly because the transborder nature of environmental problems make cooperation in this sector critical. In July 1989 Tokyo announced a significant financial commitment for protecting the environment through its aid program -- Y300 billion ($2.2 billion at Y135=$1.00) to be disbursed over the FY 1989-FY 1991 period. John Sewell, president of the Overseas Development Council, recommends several other development areas the United States and Japan could address together in addition to the environment: the Third World debt crisis; boosting foreign direct investment as a means of channeling funds to developing nations; and reconstruction in areas where regional conflicts are coming to a close.[10]

Mr. Sewell further suggests that U.S.-Japan cooperative efforts could benefit from the development of a broad level of strategic understanding that permits the two programs to proceed in parallel while keeping an eye open for direct collaborative opportunities. The development of such an understanding, Mr. Sewell says, requires three elements: an expanded consultation process; an agenda aimed at resolving the major differences in the two programs; and coordinated responses to several key development challenges.[11] The Kyoto Center's Mr. Orr also urges "some sort of institutionalized, frequent dialogue between Tokyo and Washington on foreign aid so the two countries could jointly decide how to target aid resources." He adds that regular consultations might not result in joint projects but would "help the United States and Japan develop a common economic strategy so that we wouldn't step all over each other's feet."[12]

[9] Bloch, op.cit., pp. 83-84.

[10] John W. Sewell, "A Worthy Endeavor for Japan, the U.S.," Japan Times, February 16, 1991, p. 23.

[11] John W. Sewell, "The United States and Japan in Southeast Asia: Is A Shared Development Agenda Possible?," draft paper prepared for the Center for Strategic and International Studies Project on the U.S.-Japan Economic Relationship in East/Southeast Asia: Toward a Forward-Looking, Joint Approach, June 7-8, 1990, Washington, D.C., p. 20.

[12] Japan Economic Survey, op.cit., p. 10.

Japan currently is working with other countries, too, in coordinating aid projects and reportedly has had better luck harmonizing its aid efforts with other donors, particularly with Canada and Great Britain. Both of these nations have invited OECF to explain the operation of Japan's aid program to their private sectors. Ms. Forman, formerly of AID, suggests that two factors in particular may facilitate Japan's aid cooperation with these countries. Both Canada and Great Britain have more development-oriented programs, which allow a greater focus on procurement. Their programs also are significantly smaller than AID's, which gives a greater impetus to finding opportunities to leverage their development funds.[13] Japan reportedly also is proceeding on reciprocal staff exchanges with several other donor countries.

Outlook

The reevaluations currently being undertaken by the United States and Japan of their foreign aid programs have presented ideas for changes that ironically would result in some role reversals. While the United States is considering an increase in the links between aid and American economic interests, Japan's aid program appears to be taking on a slightly more political orientation (see JEI Report No. 47A, December 14, 1990). The aid priorities and objectives that are expected to emerge also will affect prospects for cooperation.

In 1989 a congressional task force on foreign assistance concluded: "Changes in the international environment and the position of the United States, the emergence of global challenges to U.S. well-being, domestic budgetary pressures . . . and the loss of public and congressional support for the aid program all demand major changes in foreign aid legislation."[14] Since then calls for dramatic changes in the U.S. foreign aid program have increased. Some of the most energetically argued proposals are for reorienting foreign aid to support American commercial objectives.

Although a frequent complaint among some American aid officials and analysts is that Japan's foreign aid program leans too heavily toward benefiting domestic commercial interests, many in this country have begun to argue that U.S. foreign aid needs to play a more relevant role -- as do other nations' aid programs, they say -- in boosting American competitiveness. Among the steps taken toward commercializing U.S. foreign aid were the establishment of a $500 million pool of foreign aid for projects tied to American contracts, a move announced by the Bush administration last May (see JEI Report No. 21B, May 25, 1990), and Capitol Hill's decision last year to increase the limits on AID's authority to extend tied-aid credits. Furthermore, in early March Sen. David Boren (D, Okla.), backed by Sens. Lloyd Bentsen (D, Texas), Robert Byrd (D, W.Va.) and Max Baucus (D, Mont.), introduced the Aid for Trade Act. The measure would redirect U.S. foreign aid to boost American exports, in part by increasing the share of U.S. foreign aid disbursed in the form of credits redeemable for U.S. goods and services related to capital projects.

[13] Forman, op. cit.

[14] Report of the Task Force on Foreign Assistance to the Committee on Foreign Affairs, U.S. House of Representatives (Washington, D.C.: Government Printing Office, February, 1989), p. 29.

While the White House and many in Congress are against tied aid in principle, there is growing agreement that foreign aid could play a role in competing for markets abroad. Japan is seen as a prime competitor in the aid-for-trade field. Yet aid experts doubt that the tied-aid initiatives under consideration in this country have enough punch to dissuade Tokyo from continuing practices that may not involve tied aid directly but are based on a carefully laid network of relationships. Some analysts note that the tied-aid measures being eyed on Capitol Hill, in fact, might increase competition among donors.

The Bush administration has expressed its willingness to work with Congress to give the foreign aid program greater flexibility, an adjustment necessitated by budget constraints and rapidly shifting global demands. Japan's foreign aid program also has been challenged to respond to international political changes as well as to meet the expectations associated with its new position as the world's largest donor. Collaboration will depend on the extent to which the United States is willing to share and Japan is willing to assume the leadership role linked to its position as the world's biggest foreign aid donor.

Some aid analysts have suggested that progress on aid cooperation will be difficult as long as U.S.-Japan relations are tense. Disappointment in this country over Japan's contribution to coalition efforts in the Persian Gulf War has heightened friction in the relationship, already troubled by trade disputes. Assessments of the success and the potential for cooperation vary, depending on the level of coordination considered as well as expectations for the outcome. More pessimistic observers of U.S.-Japan aid cooperation echo doubts that often are applied to the bilateral relationship: too many insurmountable differences, too little agreement on priorities and objectives. Conversely, optimistic observers see a broad commonality of interests and a host of potential benefits from an aid alliance. Yet one aid expert cautions that development is a difficult field, and there is no reason to believe that collaboration in aid should be any easier than unilateral efforts.[15] U.S.-Japan attempts to cooperate on foreign aid may require adjusting expectations and approaches to fit divergent programs as well as a good deal of hard work from both sides.

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[15] Forman, op. cit.

For further information, contact Margo Grimm.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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Japan's Economy Maintains Rapid Growth In 1990 But Worries Mount

The Japanese economy continued to shine brightly in 1990, but by yearend the light seemed noticeably dimmer. The gross national product expanded a price-adjusted 5.6 percent last year, which represented an acceleration from the 4.7 percent pace achieved in 1989 (see Table). But the October-December quarter saw growth slow to an annualized rate of only 2.1 percent. Domestic demand alone would have produced 5.8 percent overall growth in 1990, but foreign trade shaved 0.2 percentage point off this rate, the fifth straight year in which net exports were a drag on the economy. The current account as a percentage of nominal GNP declined to 1.2 percent last year compared to 2 percent in 1989 and a peak value of 4.2 percent in 1986.

The 1990 GNP results were far better than expected by most analysts a year ago. The main reason was plant and equipment spending, which jumped 13.7 percent in real terms and accounted for nearly half of the overall expansion. Such spending accounted for 19.7 percent of nominal GNP, the highest figure in 20 years. (For more details, see JEI Report No. 11A, March 22, 1991.) Firms

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	1989	1990	January-March 1990	April-June 1990	July-September 1990	October-December 1990
Gross National Product	Y383,092.8 (4.7%)	Y404,524.2 (5.6%)	Y397,447.8 (6.6%)	Y402,877.4 (5.6%)	Y407,432.8 (4.6%)	Y409,539.2 (2.1%)
Personal Consumption Spending	223,296.8 (4.4%)	232,221.4 (4.0%)	229,493.1 (1.3%)	233,094.6 (6.4%)	233,453.1 (0.6%)	232,790.4 (-1.1%)
Private Residential Construction	21,661.4 (0.1%)	23,581.1 (8.9%)	22,080.3 (5.5%)	23,238.8 (22.7%)	24,616.2 (25.9%)	24,217.5 (-6.3%)
Private Fixed Nonresidential Investment	76,512.9 (15.6%)	87,025.4 (13.7%)	83,429.0 (15.2%)	85,923.6 (12.5%)	87,867.2 (9.4%)	90,577.4 (12.9%)
Change in Business Inventories	3,684.3 (14.5%)	2,914.3 (-20.9%)	2,180.7 (*)	3,348.8 (*)	3,512.8 (*)	2,607.9 (*)
Government Current Expenditures	33,510.3 (2.1%)	33,974.5 (1.4%)	33,901.9 (3.1%)	33,902.0 (0.0%)	33,945.9 (0.5%)	34,151.5 (2.4%)
Government Fixed Investment	25,042.6 (-1.2%)	25,917.5 (3.5%)	25,697.3 (6.5%)	25,958.5 (4.1%)	26,018.8 (0.9%)	26,040.6 (0.3%)
Change in Government Inventories	-87.6 (*)	128.2 (*)	203.4 (*)	433.5 (*)	603.0 (*)	-724.7 (*)
Net External Sector	-527.8 (-118.2%)	-1,238.3 (*)	462.1 (*)	-3,022.4 (*)	-2,584.2 (*)	-121.4 (*)
Exports of Goods and Services and Factor Income Received	65,779.2 (15.0%)	72,844.9 (10.7%)	73,636.7 (29.9%)	74,052.7 (2.3%)	70,837.4 (-16.3%)	72,870.7 (12.0%)
Imports of Goods and Services and Factor Income Paid	66,307.0 (22.1%)	74,083.1 (11.7%)	73,174.6 (12.4%)	77,075.1 (23.1%)	73,421.6 (-17.7%)	72,992.1 (-2.3%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

continued to invest in new plant and equipment during the second half of the year; otherwise, businesses and consumers became more cautious. Between July and December, GNP growth on an annualized basis slowed to 4.2 percent from the 6 percent pace of 1990's first half. The last three months of the year were the worst of all. Even in the fourth quarter, however, plant and equipment spending remained strong, rising 12.9 percent from the previous quarter on an annualized basis.

The only other important source of growth in the fourth quarter was the foreign sector. Real exports grew 12 percent, while price-adjusted imports shrank 2.3 percent. (The figures do not imply that Japan's current account surplus, as usually measured, increased. In fact, the imbalance declined 30.9 percent in the fourth quarter from a year earlier.) The resulting gain in net exports contributed 0.6 percentage point to the quarterly growth rate, which came in at 0.5 percent. In other words, without help from foreign trade the value of Japanese output would have declined modestly, other factors equal. Had both business investment and the external sector been neutral, the economy would have shrunk 3.2 percent in real terms on an annualized basis in the fourth quarter.

In discussing the economy's prospects analysts tend to weigh the potential for weaker plant and equipment spending and reduced net exports against the likelihood of a rebound in the rest of the economy. Unfortunately, the odds of the first scenario unfolding are much better than those of the second. An increasing number of experts believes that business investment is likely to slow dramatically over the next year, a result of higher interest rates and poor prospects for profitability. The same analysts expect export growth to be sluggish as a result of the worldwide economic slowdown.

Consumer spending, which the Economic Planning Agency said turned in a dismal October-December performance because of warm weather, is likely to rebound a little, but it is not expected to be strong enough to carry the economy. Despite appropriately cold weather, however, real household spending in January, the most recent month for which data are available, was a scant 0.1 percent ahead of a year earlier as consumer confidence remained shaky. Housing also is unlikely to pick up the slack; it probably will remain in the doldrums as long as interest rates remain high by historical standards. The data clearly reveal a temporary surge in housing investment in the middle of 1990 as potential home buyers hurried to outrace surging interest rates. This pattern suggests that housing starts last year could have been borrowed from future periods, yet another reason for pessimism concerning 1991.

If, given current conditions, the private domestic and foreign sectors are unlikely to provide much spark, then only government could provide a jump start. The most obvious alternative is lower interest rates, which could boost capital spending in the business sector and prop up the housing market. Some government and Liberal Democratic Party officials have pushed the Bank of Japan to take action, but BOJ appears to be biding its time. The bank routinely and strongly has denied recent rumors that it plans to reduce the official discount rate, stuck at 6 percent since last August 31. The central bank, in fact, still has its foot on the brake. By reducing the growth of the money supply to only 5.4 percent on a year-to-year basis in February -- the lowest rate of expansion since current yardsticks were adopted in 1979 -- BOJ has moved to tighten monetary policy and to put upward pressure on short-term rates.

Fiscal policy -- the use of government spending and taxation to affect the growth rate of the economy -- is an even less likely candidate to increase economic growth. The 1990 GNP figures, which show real government spending growing less rapidly (2.3 percent) than business and consumer outlays, could be interpreted to mean that the economy could put more spending to good use. However, price increases on the goods and services purchased by the government were greater in 1990 than for the economy in general. This result suggests that higher government expenditures could worsen inflationary pressures significantly, a major worry in an economy where the labor supply remains extremely tight.

In short, the Japanese economy appears virtually assured of slower growth in 1991 than it recorded in 1990. If, as analysts expect, real GNP expands at least 2 percent and perhaps as much as 4 percent, the economy's performance would still be impressive given the tight labor market, which limits potential growth severely. In addition, Japan's GNP is likely to expand faster in 1991 than that of the United States and other industrialized countries, where growth could be flat. These considerations imply that, despite being somewhat dimmer than in 1990, Japan's economic star is likely to appear relatively bright in 1991's darker economic firmament.

Douglas Ostrom

All Japan Watches Wage Talks

The annual nationwide negotiations between labor unions and companies over wage increases has been an important event on Japan's political and economic calendar since their inauguration after the end of World War II. The spring wage offensive, or shunto, directly affects workers' pocketbooks and companies' bottom lines and indirectly affects the entire economy through these two channels. This year's shunto, however, is being watched with particular interest by fiscal and monetary policymakers because the wage talks are taking place against a background rife with economic uncertainties. Most analysts believe that a number of circumstances will collude to limit wage increases to levels no higher than last year's and very possibly below 1990's average increase of 5.94 percent.

As is customary, maneuvering by labor and management representatives began months before the March 10 opening of direct wage talks. Workers initially felt they were in a strong position to win bigger wage hikes than last year's because the economic expansion looked unstoppable. Neither plunging share prices on domestic stock markets nor the slowing U.S. economy seemed to put a dent in private capital investment or consumer spending, the twin pillars of the current boom. Unions began laying the groundwork for wage increases of 8 to 9 percent.

Developments soon proved the Japanese economy is mortal. The Bank of Japan's credit squeeze and the events triggered by Iraq's invasion of Kuwait all began to shake consumer and corporate confidence. Price-adjusted economic growth in the last quarter of 1990 dropped to a 2.1 percent gait on an annualized basis (see preceding article). Many business leaders worry that if wages grow faster than the government's projected 3.8 percent rate of real growth in FY 1991, the resulting inflation could force the economy to sputter to an even slower pace. Employers have come to the conclusion that a wage hike equal to last year's is out of the question; they have set their sights on a pay increase of just 2.5 percent.

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REPORT

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JAPAN'S TRADE INSURANCE PROGRAM: RESPONDING TO THE THIRD WORLD DEBT CRISIS

Summary

Trade and investment insurance plays an important role in promoting business activities, particularly in developing countries where commercial and political risks are high. The worldwide debt crisis that began deepening in the early 1980s resulted in a rapid increase in the number of insurance claims as indebted countries failed to keep up with payments on their trade bills or halted investment projects. The ministry responsible for such insurance in Japan, the Ministry of International Trade and Industry, initially reacted passively to the financial crunch caused by the greater number of claims; it increased insurance premiums and suspended new contracts in an effort to keep the insurance fund self-sustaining.

Before long, however, MITI realized that a more active approach was necessary to address trade and investment opportunities in the face of the debt crisis. Responding to urgent requests from officials in recipient countries as well as Japan's private sector, MITI redefined trade insurance as an important tool for extending economic cooperation to indebted countries. As a result, the Japanese government increased its direct financial support for the program, offsetting a large portion of the deficit in MITI's trade insurance account; it permitted the fund both to borrow from government trust accounts and to tap into the general account budget.

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This more active and flexible policy generally has been welcomed by both beneficiaries and private Japanese creditors. Within Japan, however, there have been calls to improve the transparency of the premium-setting process to help minimize the adverse effects of the monopoly exercised by the government over trade insurance.

Why Trade Insurance?

As businesses expand their trade and investment activities around the world, they encounter risks that may not be present at home. Among the contingencies addressed by government-operated trade insurance programs are such postshipment problems as the failure to collect payment on exported goods or dishonored letters of credit as well as an inability to recover prepayments for foreign-supplied products not shipped. Sometimes the insurance is required if an exporter is helping the buyer to arrange financing. Investors covered by government-run insurance programs get protection against confiscation, bankruptcy and various political events.

Both trade and investment insurance basically cover commercial and political risks. A business partner's violation of a contract could have greater ramifications in foreign countries than at home, where legal or other recourses are better understood. In overseas transactions business hazards can range from poor information about the creditworthiness of buyers to changing regulatory measures and currency revaluations. These commercial risks are especially prevalent in developing countries.

Special problems for exporters and foreign investors lie in noncommercial or political risks brought about by events not linked to either party in a deal. These events include war, revolution, insurrection, civil strife and natural disasters as well as such government actions as expropriation of private property and unanticipated imposition of export and import controls, including suspension of remittances. Apart from these political contingencies, economic problems also sometimes force governments to suspend normal business activities.

Business dealings in Third World countries often are accompanied by commercial or political risks. Direct investments, particularly long-term projects, carry the most hazard. After the run-up in oil prices in the early 1970s, for example, many resource-rich countries like Mexico, Iran and Nigeria launched big, long-term projects, such as mining development and the construction of manufacturing complexes. In addition to the export of equipment some contracts involved construction and operation of the project, a factor that prolonged completion of the contract. Because of the lengthy nature and the large size of these projects as well as the often great technical difficulties encountered, the costs involved were substantial; so were the risks. Businessmen in charge of projects like these in developing countries have long seen the need for protection against political and commercial risks to reduce the chances of losses.

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What is Trade Insurance?

While exporters often obtain coverage of their goods in transit through shippers' insurance contracts or counteract currency fluctuations through options on the exchange markets, protection against commercial and political risks is not available from private insurers in Japan and Europe and is offered by only a few carriers in the United States. Since trade and investment insurance is seen as an important economic policy tool, it is handled in most industrialized countries by the government or a government-backed organization.

The Export Insurance Division of the Ministry of International Trade and Industry's International Trade Administration Bureau has operated both trade and investment insurance programs since 1950, which was 16 years after the United States created its program in the Export-Import Bank. Trade and investment insurance in the United Kingdom has been managed since 1919 by the Export Credits Guarantee Department under the auspices of the Department of Trade and Industry. France established an independent insurance company, Compagnie Francaise d'Assurance pour le Commerce Exterieur, in 1946 to deal with trade and investment insurance. Germany set up Hermes in 1917 to handle trade insurance and Treurbert in 1925 for investment insurance. The early start of a trade insurance system in Europe enabled European governments to use trade insurance to promote their countries' business overseas. The Japanese government modeled its trade insurance system on Great Britain's operation.

Governments generally have accepted involvement in the trade and investment insurance business for various reasons. Insurance claims caused by political risks in many cases are related to government actions. Moreover, governments often intervene to help reschedule debt payments. Shipments, too, sometimes are affected by government actions -- for example, if a government imposes economic sanctions on a certain country. The private sector turns to the government as a natural recourse for compensation of business losses associated with a government's actions. Less directly, insurance claims caused by political risks sometimes amount to such a large sum that no single private insurer could afford to pay off. In addition, government-supported insurance often has been provided at a subsidized price,[1] thereby assisting the domestic export sector in international competition.

MITI's Insurance Operation - Japanese exporters or investors that want to reduce the risks related to their overseas activities apply for insurance from MITI's trade insurance office. An applicant pays a certain portion of the value of its export or investment as the insurance premium. The portion, or premium rate, is conditioned by the period of the contract as well as the destination of the export or the location of the investment. The longer the contract period, the higher the premium. Additionally, MITI assesses the political risk of a recipient country and ranks it on an eight-notched scale of 0.5 to 5, the latter being the highest risk. Premium rates for highly indebted countries like Brazil, Nigeria and Poland, for example, are 10 times higher than those for the United States or Canada.

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[1] Donald Putnam Henry, The Financial Cost of Export Credit Guarantee Programs (Santa Monica, California: Rand Corp., 1987), p. 17.

Like other countries' trade and investment insurance systems, MITI's insurance account is managed on a self-sustaining basis. In principle, revenues from premiums and refunds should finance the payment of insurance claims. Since insurance covering only applicants doing business with high-risk countries would require incredibly expensive premiums, many exporters and investors join together on a comprehensive group policy to obtain the lowest rates. MITI has concluded agreements with 14 exporters' associations, such as the Japan Textile Products Exporters' Association and the Japan Machinery Exporters' Association, to cover every type of export deal by the groups' member companies regardless of destination. MITI offers discounted premiums to these firms. In turn, member companies are obligated to pay premiums based on all their export transactions, including low-risk shipments to the United States and Western Europe. In other words, in cases of comprehensive group coverage high-risk transactions are cross-subsidized by premiums paid on transactions with lower-risk countries. Because of comprehensive group coverage, MITI can afford to offer less expensive premiums for high-risk projects than otherwise would be possible. However, exporters to relatively riskless countries pay higher premiums than the degree of risk would dictate. Some analysts say this tends to blunt business evaluations of risk and to lead to higher exposure to loss. In addition, because of the group nature of the insurance, a higher percentage of the nation's exports is covered by insurance than under a system that puts more burden on the individual exporter.

When claims for losses are filed, the insurance agency's indemnity varies according to the type of insurance and whether coverage was for commercial risk, for which payments might range from 40 percent to 80 percent of actual losses, or political risk, where payments are a maximum of about 95 percent of actual losses. Proportional compensation is typical for most insurance coverage. Once a claim is paid, the agency either suspends writing new policies on transactions with the country concerned or raises premiums until the problems causing insurance claims for that country are solved. If a claimant successfully recovers its losses through the resale of insured products to other customers or eventual payment from the initial customer, it has to refund the equivalent recovered sum to the insurance agency.

The American Case - In the United States some private insurers, along with public-sector insurance bodies, offer trade and investment insurance. The Export-Import Bank runs the government's trade insurance program, but only a limited number of U.S. exporters apply for Eximbank export insurance. The total value of officially insured contracts is barely 4.4 percent of all U.S. exports; internationally the figure runs at more than 20 percent for French exports and 30 percent-plus for Japanese and British exports. The Overseas Private Investment Corp. insures against the risks involved in overseas investments, but coverage is limited to small companies; eligibility is restricted to manufacturing and mining companies with annual sales of less than $142 million or nonindustrial companies with stockholders' equity of less than $48 million.

The availability of private trade and investment insurance sets the United States apart from Japan and Europe. According to a survey by Rand Corp., private insurance companies write roughly one-third of the political risk insurance business in the United States.[2] Premiums vary on a firm-by-firm basis and take into account the risks associated with a project or deal, the types of risks an applicant wants to cover and how much coverage the applicant wants per incident. Compared with MITI's group insurance policy, which generally covers all kinds of commercial and political risks, American insurers would charge considerably higher premiums to provide applicants the same universal coverage that MITI offers. However, U.S. exporters or investors can choose exactly what risks they want to cover. If an applicant wants only a guarantee against currency inconvertibility and is not interested in insurance against losses stemming from political violence, it can pay a lower premium than would be required for universal coverage. Moreover, a manufacturer does not have to pay premiums for insurance on exports to low-risk countries in exchange for getting a lower rate for insurance covering riskier areas.

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[2] Daniel F. Kohler, Stephen W. Salant, Donald P. Henry, Keith W. Crane, Mark M. Hopkins, Economic Cost and Benefits of Subsidizing Western Credits to the East (Santa Monica, California: Rand Corp., 1984), p. 17.

Debt Crisis and Trade Insurance

Since the early 1980s developing economies have suffered serious damage from their accumulated debts. The strain from the worldwide debt crisis has dampened the business environment in Third World countries. An associated breach of payments from debt-laden concerns and countries resulted in an expansion of insurance claims at an unprecedented pace. To deal with the situation MITI undertook a fundamental review of its trade insurance policy.

Table 1 illustrates the debt situation in developing countries. Overborrowing by developing countries became a recognized problem when Mexico failed to make payments on its debt in 1982. Before long other Latin American debtor nations, such as Brazil and Argentina, followed suit. Suspension of repayment schedules also became more common among African and Eastern European borrowers. At the end of 1989 developing countries owed nearly $1.2 trillion -- the equivalent of 44.1 percent of the Third World's gross national product. Although the ratio of loan repayments to the total export earnings of developing countries dropped from 32.5 percent in 1986 to 27.5 percent in 1989, the figure still exceeded the 26.3 percent of 1983 when the debt crisis began to spread among developing countries. The capital outflow from developing countries has exceeded the inflow every year since 1983 (see Table 2). Industrial-country lenders generally have been reluctant to extend new credit to countries that are still saddled with large principal and interest payments.

One step taken by indebted countries to alleviate this credit crunch was to ask creditor governments and multilateral financial institutions to work out extended repayment schedules. Although rescheduling did not solve the fundamental problems disrupting the developing nations' economies, creditor governments generally agreed to new repayment plans and instituted programs to help provide credit flows. The total amount of officially rescheduled payments, including foreign aid loans, loans provided by public financial organizations and private credits covered by trade insurance, reached $130 billion at the end of 1989. Of the rescheduled debt, the Japanese government and private creditors were owed $11 billion, approximately 8.5 percent of the total. More precisely, official development assistance, or yen loans, comprised $1 billion, loans by the Export-Import Bank of Japan amounted to $2 billion and privately extended credit covered by trade insurance totaled $8 billion.

As soon as the Japanese government accepted a rescheduling arrangement with a country, private creditors rushed to MITI to seek compensation for the delayed payments. Since MITI agreed almost automatically to pay claims caused

Table 1: Debt Situation in Developing Countries, 1980-89

(in billions of dollars)

	1980	1983	1984	1985	1986	1987	1988	1989
Total Cumulative Debt	$573	$819	$855	$952	$1,047	$1,176	$1,156	$1,165
Long-Term Debt	428	644	684	780	882	999	980	995
From Public Sources	158	221	234	296	360	440	443	467
From Private Sources	270	423	450	484	522	559	537	528
Short-Term Debt	132	141	134	132	122	135	141	139
IMF Credits	13	34	36	40	43	43	35	32
Debt Service Ratio	21.4%	26.3%	26.1%	30.4%	32.5%	29.0%	28.5%	27.5%
Debt/GNP Ratio	27.8%	40.5%	41.8%	45.6%	48.9%	50.5%	43.9%	44.1%

Source: World Bank

Table 2: Capital Flows from Developed Countries to Developing Countries, 1982-89

(in billions of dollars)

	1982	1983	1984	1985	1986	1987	1988	1989
Borrowing by Developing Countries	$124	$108	$97	$100	$103	$107	$108	$111
Repayment of Principal	49	46	50	67	76	83	88	86
Repayment of Interest	68	65	69	70	65	64	72	77
Total Capital Flow to Developing Countries	6	-2	-22	-36	-38	-40	-52	-52

Source: World Bank

by the new payment arrangements, the balance in the government's insurance account shrank rapidly. The fund actually has been in deficit since FY 1982, a function of increased payments of insurance claims. Between FY 1980 and FY 1989 MITI paid out close to Y1.1 trillion ($8.1 billion at Y135=$1.00) in claims. Of this sum payments caused by rescheduling arrangements amounted to Y905.8 billion ($6.7 billion), or 83 percent of the total. Although part of the total rescheduled debt already has been repaid by debtor countries, MITI still is awaiting repayment of more than Y800 billion ($5.9 billion) (see Table 3).

Other nations' trade insurance agencies have suffered the same problems as MITI. According to the Bern Union, which consists of the major industrialized countries' official insurance bodies, government-operated insurance organizations in the leading developed nations recorded a large volume of red ink in 1989 (see Table 4). This country's Eximbank had the smallest deficit, adding up to only 0.83 billion Swiss francs ($530 million at 1989's average exchange rate of Sf1.546=$1.00). This distinction underscores the fact that Eximbank's trade insurance program is tapped by a limited number of U.S. exporters. European governments' insurance organizations, however, all recorded much larger deficits than did MITI.

MITI's Response to Debt Crisis

Restriction of Underwriting - MITI's initial reaction after the Mexican debt crisis was rather passive. As insurance claims for existing export contracts with Mexico began flooding into MITI, payments from the trade insurance account began exceeding revenues for the first time since its creation in 1950. Since the fund had a Y145 billion-plus ($1.1 billion) surplus that had built up through FY 1981, MITI could pay the claims using this reserve. But since this money was expected to run out in a few years, MITI officials began looking for a way to balance the insurance account in the short run.

Immediately after paying off the first Mexican insurance claim, MITI stopped writing new export insurance contracts for Mexico as well as many other indebted countries as a preventative measure to avoid an increase in claims. The ministry also restricted the total value of contracts that it would cover and introduced higher premiums for business with Latin American, African and Eastern European countries where the economic situation was judged as possibly getting worse. By the mid-1980s MITI had closed the door on trade insurance or restricted its availability for more than 50 countries.

Fewer Exports to Developing Countries - Both Japan's private sector and the governments of debtor nations complained about MITI's cautious handling of the trade insurance crisis. With Japanese exporters increasingly unable to obtain trade insurance, shipments to highly indebted countries shrank. International Monetary Fund figures indicate that worldwide exports to the 15 most indebted countries dropped from $133 billion in 1981 to $80 billion in 1984. Most big development projects in these countries were suspended or delayed as exporters and investors became less willing to ship equipment or provide financing. Japan's exports of plant and equipment to Third World countries contracted by nearly two-thirds in the 1981-84 period, tumbling from $13.7 billion to $4.8 billion. New debt repayment schedules often did little to reverse this decline because Japan, Europe and the United States continued to restrict trade insurance. Developing countries, therefore, lobbied for increased availability

Table 3: Japan's Trade Insurance Account, FY 1980-FY 1989

(in billions of yen)

	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Payment of Claims	Y22.1	Y37.6	Y62.7	Y80.5	Y141.5	Y164.3	Y169.0	Y109.5	Y164.8	Y142.7
Payment Due to Rescheduling	8.0	25.3	43.6	51.5	98.8	146.0	161.2	93.4	142.6	135.4
Account Balance	13.4	0.7	-12.7	-31.0	-74.4	-78.5	-82.0	-44.2	-103.5	-39.2
Cumulative Net Rescheduling Claims	28.4	53.7	97.3	148.8	247.6	393.6	437.8	507.3	677.9	818.8
Cumulative Net Borrowing from Fiscal Investment and Loan Program	0.0	0.0	0.0	0.0	0.0	74.0	164.1	219.5	284.8	294.1
Cumulative Government Funding from General Account Budget	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	97.0	100.2

Source: Ministry of International Trade and Industry

Table 4: Major Industrialized Countries' Trade Insurance Account, Cumulative 1982-89

(in billions of Swiss francs*)

	Total Receipts	Total Payments	1989 Yearend Balance
Japan (EID/MITI)	Sf4.79	Sf10.48	Sf-5.69
France (COFACE)	17.55	24.89	-7.34
Great Britain (ECGD)	8.91	17.22	-8.31
West Germany (HERMES)	5.52	12.33	-6.81
United States (Eximbank)	1.06	1.89	-0.83

*Swiss franc 1.5465=$1.00 at 1989's average exchange rate.

Source: Bern Union

of trade insurance and the extension of new credits to help them recover from their economic straits.

MITI's tough line on new trade insurance meant the private sector was likely to forgo business opportunities in developing countries where the risks of default were high. To make matters worse manufacturers that had group policies still had to pay the same insurance premiums even though their exports generally were headed to low-risk countries, such as the United States. This increased the frustration of group policyholders since they saw little merit in paying premiums for low-risk exports unless the government extended insurance coverage to riskier shipments to highly indebted countries.

Finding an Alternative Funding Mechanism - As the debt crisis deepened MITI's trade insurance account deteriorated (see Table 3). Payments attributable to rescheduling arrangements totaled Y98.8 billion ($731.9 million) in FY 1984, nearly double the previous year's payouts. Furthermore, premium income had decreased in line with the ministry's new restrictions on writing insurance. The trade insurance account's self-sustaining nature therefore was jeopardized. By FY 1985 the reserves built up through the 1970s were exhausted. Facing a funding shortfall, MITI asked the Ministry of Finance to allow it to borrow money from the trust funds used to finance the Fiscal Investment and Loan Program, the government's capital budget.

To justify this unprecedented request MITI reviewed its handling of insurance claims related to the debt crisis. Since the claims were in response to debt-rescheduling arrangements, MITI reasoned that once developing countries repaid their loans, the money paid out in trade insurance claims would be refunded and the ministry then could repay the trust funds. Thus, while the trade insurance account would remain in the red for some years, it would be balanced over the long run -- provided that indebted countries eventually paid off their loans. This provided MITI with the rationale to tap the trust funds. Between FY 1985 and FY 1989 the ministry borrowed a total of Y294.1 billion ($2.2 billion).

Relaxation of Underwriting Guidelines - Responding to the requests from developing countries as well as Japan's private sector for a more liberal trade insurance-writing policy, MITI relaxed its restrictions on export coverage for several Third World nations. Not only did this relaxation benefit selected countries as well as Japanese companies doing business there, but it also contributed to an increase in the insurance account's receipts. To many analysts MITI's revised policy represented an acceptable compromise between its fiduciary responsibilities and the demands of Third World countries and Japanese exporters.

New Problems and New Thinking

Introduction of New Debt-Relief Measures - While the rescheduling of loan repayments brought short-term relief to struggling developing countries, the fundamental economic causes of their financial problems had not been addressed. Still seeing little basic reform by the end of the 1980s, lending nations and international financial institutions like the World Bank and the IMF reluctantly concluded that drastic debt-relief measures were unavoidable, including cancellation of part of some countries' cumulative debt (see JEI Report No. 7A, February 22, 1991). Following a 1988 accord among the seven leading industrialized economies at their summit meeting in Toronto, Japan promised to write off a portion of the outstanding debt owed by 18 countries with low national incomes, particularly in sub-Saharan Africa. Credit from private sources covered by trade insurance was included in the debt eligible for cancellation, as were ODA loans.

Highly indebted middle-income countries, such as Mexico, Venezuela and the Philippines, qualified for a new debt-relief strategy initiated by Treasury Secretary Nicholas Brady in March 1989. The Brady Plan's goal is to reduce the burden of long-term loans from private-sector financial institutions (see JEI Report No. 6B, February 9, 1990). Moreover, negotiations on a large-scale reduction of Poland's debt, including bank loans covered by trade insurance, have begun. Poland owes Japan an estimated Y190 billion ($1.4 billion).

While the Brady Plan and similar debt-relief measures help struggling developing countries, these steps cause problems for Japan's trade insurance program since debt cancellation means the loss of money. By extension, part of the current deficit in the account never will be wiped out since countries like Mexico and the Philippines no longer are obliged to repay some loans against which trade insurance was written. Thus, MITI's rationale for borrowing from government trust funds to tide over the trade insurance account has been undercut to some extent.

Impact of Persian Gulf Crisis - The Persian Gulf crisis that began last August when Iraq invaded Kuwait generated an increase in insurance claims on trade with both Iraq and Kuwait as well as with frontline states like Egypt and Turkey that were hard hit by the international trade embargo against Baghdad. At the time that Tokyo froze all business transactions with Iraq and Kuwait private financial institutions in Japan had Y430 billion ($3.2 billion) in loans outstanding to Iraq and Y80 billion ($592.6 million) outstanding to Kuwait. Roughly Y218 billion ($1.6 billion) of Iraq's loans and Y40 billion ($296.3 million) of Kuwait's came due during FY 1990. Under the terms of trade insurance contracts MITI had to compensate lenders for the nonpayments. Moreover, while the full extent of damage to Japanese-owned facilities in Kuwait and Iraq remains to be seen, some Japanese investors are expected to withdraw from ventures in these two countries and probably will file claims for compensation based on their investment insurance.

Claims for Investment Insurance - Unlike export insurance claims, few investment insurance claims have been filed -- in part because Japanese direct investment in developing countries was limited until the early 1980s but also because political incidents like expropriation or war have been rare over the past decade. If, however, political events cause Japanese investors to file claims, the amounts involved are likely to be huge. For its part MITI has little expectation that the money it pays out to investors will be recovered from the offending country's government.

The dissolution of the Iran-Japan Petrochemical Corp. is a good example. Insurance claims filed in connection with this project, a joint venture between the Iranian government and a Japanese consortium consisting of the Mitsui Group's five main companies and the Overseas Economic Cooperation Fund, have reached Y93 billion ($688.9 million) -- the largest amount ever filed with MITI by a single contractor. Launched 19 years ago, the IJPC project was affected by a series of political events in Iran. Work on the Bandar Khomeini petrochemical complex was suspended during the 1979 revolution, although 85 percent of the facility had been built. The two sides later agreed to resume construction, but the outbreak of the Iran-Iraq War resulted in several critical parts of the facility being destroyed from Iraqi bombing (see JEI Report No. 36B, September 22, 1989). In 1989 the two parties finally agreed to dissolve the joint venture into which the Japanese side alone had invested over Y300 billion ($2.2 billion). Whether MITI will pay all the insurance claims remains unclear. What is more certain is that MITI will have to find revenue sources other than loans from government trust funds to offset the cost of unrecovered payments.

MITI's Response to Prospective Account Shortfalls - Facing expected increases in unrecovered insurance expenses, MITI has begun to take another look at its trade and investment insurance program. The ministry's major concern is who should be asked to cover the large deficit looming in the insurance account, Japanese businesses or taxpayers? In FY 1989 MITI pressed both the private sector and the Ministry of Finance for help with the shortfall.

After consultations with the business community MITI boosted insurance premiums approximately 40 percent on average starting in FY 1989. MITI also maneuvered manufacturers of electronics goods and motor vehicles into joining group insurance programs. Although these products rank as Japan's top exports, electronics and automotive makers had used trade insurance only rarely, mainly because a majority of their overseas shipments go to the United States, Europe and Southeast Asia. For these companies the premiums for trade insurance are equivalent to export surcharges. The automotive and electronics industries eventually bowed to MITI pressure, mainly because they were trying at that time to expand markets outside the United States and Europe.

As a result of the 40 percent premium hike and the larger number of exporters participating in group insurance plans, premium income jumped 60.6 percent in FY 1989 (see Table 5). The value of insured contracts also climbed, going from almost Y8.7 trillion ($64.1 billion) in FY 1988 to Y18.3 trillion ($135.5 billion) during the April 1989-March 1990 time frame. Over the same period Japan's total exports increased a modest 11.1 percent to Y38.9 trillion

Table 5: Japan's Trade Insurance Account, FY 1988-FY 1989

(in billions of yen)

	FY 1988	FY 1989	Percent Change
Value of Insured Contracts	Y8,647.4	Y18,295.2	111.6%
Premiums	21.3	34.2	60.6
Refunds of Rescheduled Credits	40.0	69.2	73.0
Payments for Insurance Claims	164.8	142.7	-13.4
Balance	-103.5	-39.3	

Source: Ministry of International Trade and Industry

($288 billion). Since the value of insured contracts includes long-term exports as well as foreign direct investment, it is difficult to figure out what portion of Japan's FY 1989 exports were insured. Nevertheless, the beginnings of a drastic expansion in insured contracts are clear, and that development contributed to higher premium income.

While pressing exporters to shoulder more of the cost of the trade insurance system, MITI also lobbied the Finance Ministry for funding from the general account budget. Between 1950 and 1988 the government's initial Y6 billion capitalization of the trade insurance program had been increased by only Y1 billion. Compared to the trade insurance agencies of other countries, such as the Eximbank with its $1 billion in government-supplied capital, the Y7 billion ($51.9 million) capitalization of the Japanese program was small. The value of insured export contracts was more than 10 times higher than Eximbank's, yet the MITI-run insurance system had only one-twentieth of its counterpart's capital. As long as Japanese exports grew at a rapid rate annual premium income covered current losses, even though projected risks were underfunded on a long-term accrual basis. When payouts finally caught up with receipts not only were higher premium rates necessary, but a beefed-up capital structure was required as well.

In 1988 MITI asked the Ministry of Finance to earmark money in the general account budget to increase the capitalization of the trade insurance system to at least Eximbank's level. Getting financing from the general account budget would mean that taxpayers ultimately covered insurance claims paid to the private sector, but MITI officials reasoned that trade and investment insurance not only benefits the business community but also enhances Japan's economic cooperation with the developing world.

Although initially designed to reduce risks for Japanese exporters and overseas investors, the trade and investment insurance program became recognized as an important tool for facilitating help to developing economies via private-sector activities. Most developing countries have asked for assistance from Japan's business community as well as the government's foreign aid program in the belief that private-sector involvement will contribute directly to strengthened export competitiveness. Trade insurance has been assigned the role of encouraging the private sector's activities in the developing world, especially if otherwise there is a chance that companies would hesitate to provide loans or invest there.

Based on this justification, the government decided to expand the trade insurance system's capital by drawing on the general account budget. The FY 1988 supplemental budget provided a Y90 billion ($666.7 million) infusion. Another Y3.2 billion ($23.7 million) was included in the initial FY 1989 budget. Of this, Y1.7 billion ($12.6 million) was considered foreign aid since it compensated for the cancellation by Japanese commercial creditors of low-income countries' debt. The initial FY 1990 budget contained Y3.7 billion ($27 million) more money, of which Y2.15 billion ($15.9 million) was counted as ODA; an additional Y40 billion ($296.3 million) was approved as part of that year's supplemental budget process. Funding in the current fiscal year's initial budget jumped to Y8.5 billion ($63 million), including nearly Y2.6 billion ($18.9 million) classified as foreign aid. As of April 1991 MITI's trade and investment insurance account had a Y152.3 billion ($1.1 billion) reserve -- an amount equivalent to Eximbank's capital.

More Flexible Operation - Trade insurance can play an important role in helping the economies of indebted countries recover by promoting capital inflows from the private sector, but MITI's earlier scheme generated only broad incentives to export to or invest in countries with above-average risk assessments. Recently the ministry has begun using trade insurance as a tool to promote economic relations with particular developing countries. Instead of suspending trade insurance for highly indebted countries like Brazil and Poland, MITI policymakers have indicated a willingness to approve certain types of export or investment insurance contracts for these borrowers -- provided officials are convinced that the insured transaction will accelerate economic recovery in the recipient countries. MITI also extended trade insurance to Turkey and Egypt during the Persian Gulf hostilities in line with Japan's economic support for frontline states, even though political and commercial risks increased tremendously.

As part of its new case-by-case approach to providing insurance, MITI has begun to require applicants to pay surcharges for contracts involving countries where insurance previously has been suspended. Although premium rates typically are defined by regulation, there is no public reference table for the surcharges since they are worked out between the ministry and individual applicants. Some experts estimate that the extra payments often are two or three times greater than the highest premium rate applicable to normal insurance contracts.

Given MITI's monopoly on trade insurance in Japan, exporters have the choice of paying the surcharges set by the ministry or abandoning the transactions they wanted to insure. Japanese companies interested in investing in high-risk countries do have an alternative source of insurance, the Multilateral Investment Guarantee Agency, which is a World Bank affiliate. To avoid end runs of its national monopoly, however, MITI asks Japanese businesses to consult it before applying to MIGA.

Despite the drawbacks for both deeply indebted Third World countries and Japan's business community of MITI's current approach toward trade and investment insurance, ministry officials believe their case-by-case strategy is preferable to a blanket suspension of insurance coverage for high-risk nations. Analysts argue, however, that a more transparent system would minimize any harmful effects of MITI's monopoly. They add that greater transparency is all the more necessary because of the substantial amount of taxpayer money that has been funneled into the trade insurance account in recent years to cover the fund's red ink.

Participation by Private Insurers - Some experts have suggested that a dose of competition would improve the situation. Until recently private insurance companies would have been hard-pressed to compete with the MITI-run trade and investment insurance system with its pooled rate structure. MITI's current case-by-case approach to providing coverage on transactions with high-risk countries, however, is similar to how American insurance firms write trade and investment insurance. That raises the possibility that private insurers could compete successfully with the government's program. To date, though, no insurance company has indicated any interest in going into the trade insurance business in Japan. In any case the Finance Ministry would have to sanction such an operation, since it regulates the insurance industry. MOF, which is involved in multilateral debt-relief arrangements for Third World countries as well as in MIGA's activities as the Japanese government's representative, has become more interested in trade and investment insurance, especially since MITI began asking for government funding of its program. That could set the stage for another review of the basic policies and the operation of the government's trade and investment insurance system. Such a study no doubt would explore the possibility of allowing private carriers to write trade and investment insurance.

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NO. 15A April 19, 1991

STATISTICS, LIES AND COMPUTER TAPE: UNTANGLING AGGREGATE U.S. AND JAPANESE TRADE DATA

Summary

The oft-quoted expression "lies, damn lies and statistics" seems particularly applicable to the various measurements of Japan's external imbalance and its trade account with the United States. While Japanese and American trade and payments statistics, in themselves, are honest attempts to portray a complex situation, policy analysts on both sides of the Pacific have engaged in a thriving cottage industry in their misuse.

Policymakers have a surfeit of choices that measure external imbalances in this country and Japan. Alternatives include broad versus narrow data, American or Japanese figures, yen or dollar measures, bilateral or global imbalances and real versus nominal figures. American critics of Japan have concentrated on dollar-denominated bilateral trade statistics; these show, perhaps coincidentally, what appears to be a very serious and chronic imbalance. By contrast, other measures point to a decline in Japan's external imbalance of more than 70 percent between 1986 and 1990.

Deriving appropriate implications for policy from current account or trade statistics has proven equally problematic. If pressed, most policymakers will admit that external imbalances reflect mainly macroeconomic factors rather than import or export barriers. Key to this conclusion is the fact that trade imbalances equal capital flows, which are largely independent of trade barriers. Hence, American efforts to remove real or imagined Japanese trade restrictions cannot be expected to have a substantive effect on the bilateral trade imbalance. Yet policymakers frequently have acted as if they believe otherwise. Serious efforts

to reduce external imbalances in the United States and Japan necessarily involve reducing the savings-investment gap in each country; the U.S. federal budget deficit easily is the most important potential target in this regard.

What Trade Statistics Mean

Two hundred years ago nations had a straightforward belief in how to get rich through foreign trade. Under the prevailing theory of mercantilism a country attempted to have its exports exceed its imports by the largest possible amount. Surpluses in foreign trade, which resulted from the successful pursuit of this objective, were seen to be a measure of a nation's wealth in exactly the same way that a household budget or a corporate balance sheet reflects the efforts of an individual or a firm to maximize the difference between income (revenue) and expenses. However, economists later countered that a policy of continually shipping the fruits of a country's labor and other resources in exchange for money, IOUs and gold did little to benefit a particular nation, although it would help specific exporters and firms facing import competition.

Virtually no one in a position to advocate policy will admit to being a mercantilist today. However, some 20th century beliefs are consistent with this philosophy. Advocates of export-led growth, for example, have argued that an increase in exports has spillover effects on demand elsewhere in the economy as the trade proceeds are spent. In a situation where domestic demand is inadequate and unemployment high, increased exports may make the nation richer. Similarly, if demand shifts to domestic products from imports, the output of domestically produced goods would increase and, as a result of the multiplier effect, boost national output. Of course, this argument implies there are limits for export-led growth strategies; such policies would work only up to the point at which labor is fully employed and in situations where a country's trading partners do not adopt similar policies.

During the Great Depression some countries did adopt such "beggar-thy-neighbor" policies, whereby they attempted to resolve the problem of insufficient domestic demand by increasing net exports. These actions and the inevitable efforts of their trading partners to insulate themselves from such damage were factors leading to a contraction of world trade in the 1930s. (Ironically, such efforts would have had only a small positive effect on domestic employment even in the absence of retaliation; in many countries, including the United States, exports and imports were not large enough to have much effect on gross national product.)

In the postwar period the world community established new multilateral arrangements in an effort to avoid beggar-thy-neighbor policies. The General Agreement on Tariffs and Trade sought to prevent nations from imposing trade barriers; the International Monetary Fund was established, in part, to maintain fixed exchange rates that would prevent competitive currency rate depreciations.

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The rationale behind GATT and the IMF was to prevent nations from competing to establish large trade surpluses. In other words, the prevailing philosophy was that nations should avoid mercantilism because it hurt other countries. As such, discussions throughout the postwar period generally have left unanswered an important question concerning mercantilism: if a nation can get away with efforts to expand its external surplus, does it benefit in the end? Many experts believe that nations have continued to act as if such mercantilistic policies would enhance their economic welfare since they appear to be pursuing these types of policies within the strictures created by the IMF and GATT. These same experts have pointed to Japan as a leading practitioner of export-led growth and, ultimately, mercantilism.

Japan, in fact, did place a high priority on the export side of its trade account during the 1950s and 1960s, although some of Tokyo's efforts were directed toward avoiding excessively large trade deficits. Whether Japan's actual growth during this period can be characterized as "export-led" is open to debate; some evidence suggests that exports grew only after domestic growth had occurred. In any event, Japan's rapid economic expansion from the 1950s through the mid-1980s, coupled with declining trade deficits and then mounting trade surpluses, suggested to some observers that mercantilist policies were more effective than had been thought previously. (By the mid-1980s, if not sooner, Japan's stated policy objectives had shifted to favor a reduction in what had become its large trade surplus.)

Economists, however, remain skeptical that trade surpluses are an unmistakable sign of successful economic policy. In broad terms a surplus in foreign trade means simply that a nation produces more than it consumes and invests. If a nation works to live rather than lives to work, economic well-being is better judged by what is consumed or otherwise used rather than what is produced. In such cases a trade surplus is desirable only if it leads to higher levels of consumption over the long run.

Although a trade surplus can be beneficial, it need not be. In the 1950s the United States had a large worldwide trade surplus year after year. One consequence was rising U.S. direct investment around the world. Considering its small size, Cuba got more than its share, accounting for about 3 percent of outstanding U.S. investment abroad in 1958. After the Cuban revolution in 1959 Havanna confiscated U.S. assets without compensation, leaving the United States about a billion dollars poorer; approximately that portion of cumulative U.S. trade surpluses was virtually for naught. Likewise, many nations have clearly benefited from trade deficits. For example, late 19th and early 20th century America had large trade deficits, a consequence of heavy demand to build this country's industrial base. Those purchases made American industry and workers more productive, with positive implications for living standards and, not incidentally, this country's trade surpluses by the middle of the 20th century.

What about Japan? Some analysts have described Japan as producer- rather than consumer-oriented. This corresponds to a view of Japan as a latter-day King Midas, more concerned about making and accumulating trade surpluses than spending them. Of course, the king eventually found to his regret that mere accumulation of monetary assets benefited him little. If, however, an individual or a nation derives satisfaction from earning money rather than spending it, then it may be happier with a larger trade surplus, without regard to how it is invested. In this case mercantilism may make economic sense -- provided it does not provoke a response from trading partners and the country in question does not care about hurting the economies of other nations.

This situation, however, does not appear to apply to Japan. During the postwar period Japan has had high rates of GNP growth and rapid rates of increase in consumer spending compared to a broad range of other countries. This result suggests that policymakers there have not had to choose between the producer and the consumer; helping the producer has led to higher output, which, in turn, has helped the consume In fact, given the current pressure from labor unions for shorter work hours and from a variety of sources for more public amenities, the assumption that Japan would choose production over consumption may well be incorrect.

External Surpluses and Capital Flows

Underlying any discussion of trade and current account imbalances is an inevitable acknowledgment of capital flows. As noted above, a surplus implies that a country produces more than it uses; a deficit, the reverse. This means that a surplus country collects an IOU from the deficit country. The sum of such debts equals the difference between what a nation produces and what it uses domestically.

At this level of abstraction most people will accept the linkage between surpluses and capital flows. When it comes to actual policies, however, the connection may get lost. For example, American policymakers sometimes talk as if they would like to reduce this country's trade deficit while maintaining the inbound capital flows that keep interest rates at relatively low levels. In particular, Washington would like to see U.S. sales in Japan increase. However, the result of higher U.S. exports to Japan is to set one or more processes in motion, depending on how the U.S. exporter uses the proceeds of its sales; these actions either will lead to a smaller net inbound capital flow or offsetting increases in Japanese exports to this country. Three alternatives serve to illustrate the linkage between trade and capital flows.

One possibility is that a company expanding sales to Japan exchanges the yen received in payment back into dollars, which is, after all, how it pays its employees and suppliers. In this case the increased level of U.S. exports results in additional yen on foreign exchange markets, pushing down the value of that currency. As a consequence, Japanese exporters will find selling goods in the United States and elsewhere more attractive; Japan's surplus may end up unchanged. In this scenario higher U.S. exports have been matched by higher Japanese exports.

A second possibility is that the U.S. exporter simply may keep the yen, without exchanging it on currency markets or depositing it in a financial institution. Here, although the importer has met its obligation to the exporter, Japan as a nation still has a liability since the exporter has yen that it can convert or spend; in other words, the American company makes the equivalent of an interest-free loan to the country whose currency it holds. Ordinarily, this claim would be represented in the capital flow portion of the balance of payments statistics, although it could end up as part of "errors and omissions" if it goes unreported.

Thirdly, the hypothetical American exporter may accept a dollar payment drawn on the Japanese importer's Eurodollar account, depositing it in the U.S. firm's own Eurodollar account. The capital flow dimension in this instance is the same as for the exporter that withdraws its payment from the financial system by putting the money in a safe or under a mattress. While the American seller has increased foreign assets, the reduction in the Japanese buyer's Eurodollar account implies reduced Japanese foreign assets, arithmetically the same as increased liabilities. In this example higher Japanese import levels would be matched in the Japanese data by an equal reduction in net capital outflows. The U.S. balance of payments, in turn, would record higher exports matched by higher net capital outflows (or lower net capital inflows) since the transaction would involve an increase in the assets held abroad by Americans.

Many more examples could be cited of actual capital movements, involving Euroyen, long- and short-term funds, equity investments and direct investment in manufacturing facilities abroad. On inspection, however, all these alternatives end up being variations on a theme, with the effect of increased U.S. exports to Japan, for example, implying either an exchange rate change, higher net U.S. assets abroad, lower net Japanese foreign assets or some combination of the three.

What Causes External Imbalances?

The origin of external imbalances owes much more to exchange rate changes and capital inflows and outflows than to changes in export and import demand. This conclusion is not obvious from the approach taken by American and Japanese policymakers.

Changes in Export or Import Demand - Trade negotiators are likely to imply that a reduction in external imbalances can be achieved by adjusting import or export barriers. For example, in a rapidly growing Japanese economy imports could be expected to rise, other factors equal, reducing the trade surplus. Similarly, if the United States were to loosen its restrictions on imports from Japan, the U.S. trade deficit would widen, other factors equal. In fact, this alternative is unlikely because other factors can be expected to change as well. If the demand for U.S. products in Japan were to increase, for example, exchange rates probably would be set in motion as well. The increased demand for dollars to pay for U.S. exports would lift the value of the American currency but also lead to higher exports from Japan; this eventually would bring about a reduction in the level of U.S. exports to Japan.

How far would the exchange rate adjust? Recall that the counterpart of a trade imbalance is a capital flow. The desired capital flow depends on interest rates in the two countries. As long as interest rates do not change, the amount of the capital outflow will not change. When coincidental interest rate changes are not a factor, the exchange rate will adjust only enough so as to keep the capital flow in lockstep with the current account. In other words, a shift in export or import demand is unlikely to lead to a change in the external imbalance.

This argument may be viewed in another way. A jump in Japanese demand for U.S. products implies that American companies get more Japanese funds. What do they do with this money? Only if it is hidden in mattresses or otherwise passively invested in Japan will the increased exports enhance the U.S. trade balance. This is unlikely to happen; unless Japanese interest rates rise, U.S. exporters will not want to add to their holdings of yen-denominated instruments. On average exporters have no reason to expect higher Japanese interest rates. However, if they try to exchange yen for dollars, the exchange rate moves, with the predicted consequences of higher Japanese exports.

Capital Flow-Related Changes - Alternatively, the change in Japan's external imbalance could be a result of changes in optimal capital flow patterns. For example, if the federal government in the United States increases its borrowing, it puts pressure on capital markets, other factors equal. As a result, interest rates rise in this country, attracting increased capital from abroad. This factor, in turn, creates a demand for the dollar, pulling up its value. As a result of the more expensive dollar, U.S. exports decline and imports rise. In short, increased U.S. demand for capital leads to a corresponding hike in the trade deficit and inbound capital flow.

This conclusion has dramatic implications for trade policy. It suggests that market-opening initiatives involving the Japanese market are likely to have little, if any, effect on the trade imbalance. Conversely, changes in capital market demand are likely to have a powerful influence on the imbalance. For this reason U.S. and Japanese negotiators agree, in their more thoughtful moments, that the key to reducing Japan's trade surpluses and America's trade deficits is not endless trade talks but rather actions affecting the demand for capital in each country.

Ironically, U.S.-Japan talks that go beyond trade matters are more likely to have an impact on the bilateral trade imbalance than those with a narrower focus. For example, in the Structural Impediments Initiative the two sides discussed and made promises concerning fiscal policies in addition to those involving market access and other issues (see JEI Report No. 26B, July 6, 1990). In this case, however, Tokyo and Washington avoided fiscal commitments that necessarily would have changed international capital flows substantially.

The capital flow argument entails another question. What causes the international flow of funds? The answer is complicated but boils down to a simple concept: demand and supply of capital on domestic markets. For example, since the early 1980s Tokyo has played an important role in the determination of Japan's external imbalance; its actions to reduce the deficit in government spending relative to GNP sometimes have been the opposite of those made in Washington.

Other dimensions of the supply and demand for capital in Japan exhibit a less clear-cut pattern. Although Japanese corporate spending on plant and equipment stagnated in the early 1980s, it has increased dramatically since 1986, putting upward pressure on interest rates in Japan and, through those rates, the value of the yen. From April 1986, the start of FY 1986, to the March 1990 end of FY 1989 (FY 1989 being the most recent year for which data are available) increased demand in the corporate sector for funds more than offset decreased public-sector demand. (For details, see JEI Reports No. 15A, April 14, 1989, and No. 11A, March 22, 1991.)

In addition, Japanese household savings rates declined slowly in the 1980s, but they remain high compared to most of Japan's trading partners. In 1989, the most recent year for which data are available, households saved 13.8

percent of their disposable income, down from levels averaging more than 18 percent at the beginning of the decade but still triple U.S. rates by conventional measures. Since household income -- the source of savings -- has grown and demand for capital within the household sector for housing has varied, the amount of yen-denominated household savings available for financing corporate activity has shown an up-and-down pattern.

In short, movements in the supply and demand for capital in Japan have fluctuated and partly offset each other. That leaves non-Japanese factors as the dominant factor in international capital flows. In this respect the U.S. budget deficit reigns like an 800-pound gorilla. Not only is it larger than the other factors but it increased dramatically in the early 1980s and has experienced only a modest decline since then. It should come as no surprise that the U.S. current account deficit measured against GNP tracks very closely the budget deficit measured on the same basis. Even the Japanese current account surplus shows a similar relationship to the U.S. budget deficit. Japan's still-high household savings rate explains why Japan -- rather than America's other trading partners -- has ended up financing such a large share of the U.S. capital shortfall.

Measuring External Imbalances

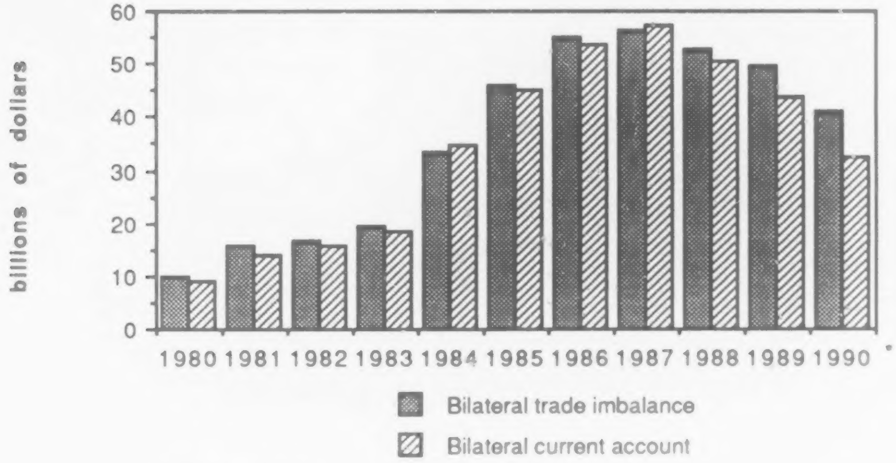
In short, external surpluses or deficits do not mean what they seem to mean. They have a lot to do with monetary and fiscal policies that create conditions in capital markets and very little to do with commercial policy that could be motivated by mercantilist ideology. Of course, both Washington and Tokyo still monitor the direction of the current account and the trade imbalance closely. Once policymakers decide to worry about external imbalances, they face the choice of which of many possible measures to emphasize. The policy implications drawn from the numbers may well differ depending on which measure is chosen.

Policymakers have many possible yardsticks from which to choose. Some measure trade in the most narrow sense; others include transactions not uniformly considered to be trade at all. In addition, trade may be measured bilaterally or globally and in nominal dollars, nominal yen or in real terms. Finally, trade can be measured relative to other variables such as GNP.

The most widely cited statistic in the United States of Japan's trade position is the U.S. figure for the trade balance between the two countries measured in dollars. After growing rapidly during the early 1980s, this country's huge trade deficit with Japan has declined slowly in recent years. The alleged "stickiness" of the imbalance, especially when compared to greater declines in other bilateral U.S. imbalances, such as that with Europe, has led some American observers to conclude that its persistence is somehow Tokyo's fault.

This statistic probably gets the publicity that it does primarily because of its relative immediacy: it is reported monthly six weeks after the period it measures. (January data are released in March, for example.) However, it suffers from some noticeable defects, the most obvious being limited coverage. Trade in services, such as tourism, is not measured; nor does income from foreign investments get incorporated. For U.S.-Japan transactions these omissions have tended to make the bilateral imbalance appear larger than it actually is. Figure 1 contrasts the bilateral trade figures with statistics that resolve these difficulties -- current account data, which show a somewhat smaller gap. However, since current account figures are released only quarterly and come more than two months following the end of the period they describe, the numbers receive less press play in this country.

Figure 1: U.S. Measures of Bilateral Trade



*Preliminary

Source: Department of Commerce

The Ministry of Finance publishes a trade figure conceptually similar to the monthly U.S. trade numbers. Imports are measured on a cost, insurance and freight basis, as opposed to the U.S. data, which exclude insurance and freight. For this reason Japan's imports from the United States seem larger according to the Japanese data than they do in the U.S. figures, with the result that Japan's trade surplus seems smaller than the counterpart U.S. trade deficit. The two data series, however, have other differences that largely offset each other.*

In 1990 the Japanese measure of the bilateral trade imbalance in goods was $38 billion, a drop of 15.4 percent from the 1989 number (see JEI Report No. 5B, February 8, 1991). By comparison, the U.S. figure came to $41.1 billion, a 17.5 percent contraction, suggesting how similar the two statistical series are. (All the 1990 figures are preliminary.) The emphasis on the American data in the United States is understandable but somewhat inappropriate since Tokyo's figures come out a full month earlier. The distinction was striking on at least one occasion when Wall Street reacted with alarm to a U.S. figure for bilateral trade even though market analysts could have looked at a more calming figure put out the same day by the Ministry of Finance; MOF's more timely data described an additional month's events and presented an opposite picture.

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*For details, see "Nichi-bei Boeki Tokei: Sai-wa Unchin Hokenryo-nado-ga Shuin," Toyo Keizai Tokkei Geppo (May 1991), p. 33.

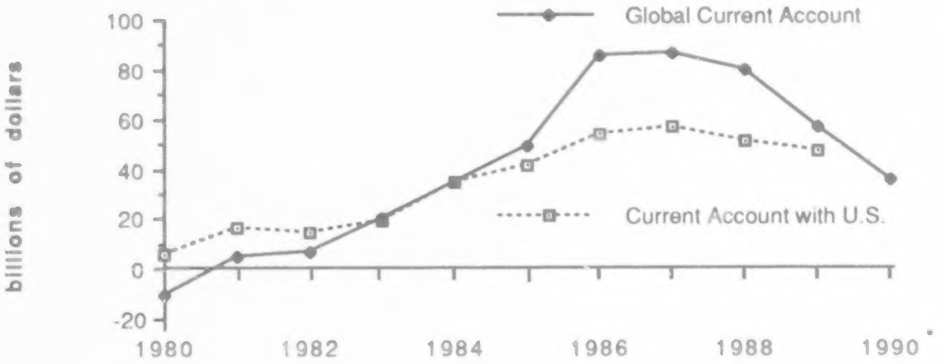
Japan also publishes bilateral current account data. The numbers are even less timely than the corresponding U.S. figures. Prepared by the Bank of Japan, the statistics are available only on a semiannual basis. The most recent number as of early April 1991 is for the first half of 1990; it shows a $19.1 billion imbalance, down from $23 billion in the same period of 1989.

Despite the press play that many of these bilateral figures get, most serious analysts regard even the most comprehensive of them as deficient. While the United States is Japan's largest trading partner and Japan is the largest supplier to and the second-largest market for the United States, neither country dominates the other's trade. Bilateral data focus excessively on this trade to the exclusion of all other transactions. More important, however, is that an emphasis on bilateral data tends to lead to the conclusion that U.S.-Japan trade ought to be balanced.

Such a view is nonsense even if one agrees that external balances are important. Given any nation's comparative advantage, one would expect it to have chronic surpluses with some countries and persistent deficits with others. Japan is a particularly good example. As a country with virtually no raw materials, it is a big importer of industrial and agricultural inputs. If, as is the case, it has huge deficits with countries such as Saudi Arabia, it needs surpluses with others just to maintain global balance. If Japan's trade with the United States were in balance, it probably would have a substantial deficit in its overall trade. In short, Japan's chronic surplus with the United States is partly offset by deficits with a variety of other countries.

The need to look beyond Japan's bilateral trade flows suggests the benefit of looking at Japan's worldwide exports and imports. Figure 2 shows Japan's global current account imbalance as measured in dollars and, for reference, Tokyo's measure of the surplus with the United States. The series also is available denominated in yen. In some respects these statistics represent the fullest picture of Japanese trade since they include all transactions and all countries.

Figure 2: Japan's Current Account



*Preliminary

Source: Bank of Japan

It is this series that corresponds to Japan's net overseas capital flow. The Table shows the relationship between trade data, the current account and international capital transactions. Exports and imports determine the trade balance (row 3), which, unlike the Ministry of Finance customs-clearance trade statistics discussed above, is measured net of insurance and freight charges. Adding services and transfers (both of which may be positive or negative) to the trade figure gives the current account imbalance (row 6). The figures below this show the purposes to which the surplus was put (capital flows), which may be long- or short-term, private or public. (Further details on the composition of the capital flow are available in JEI Report No. 7B, February 22, 1991. The result of continued large capital flows -- an increase in Japan's international creditor position -- is detailed in JEI Report No. 38A, October 5, 1990.) In total they equal the current account imbalance (row 22). The "errors and omissions" line is an indication of the extent to which data collected from different sources are inconsistent with the equality demanded by double-entry bookkeeping.

The data in the table show a consistent pattern in Japan's global imbalances in recent years. The decline in its trade surplus has been modest, but the drop in the more comprehensive current account imbalance substantial. By definition the decline in capital flows has matched this contraction, with private capital flows generally rising or falling in synch with the current account. The one exceptional year in this regard was 1987; in that year surging short-term capital inflows and bank liabilities (rows 18 and 21), coupled with near-constant long-term outflows, reduced net private outflows in the face of a somewhat larger current account surplus. The data show that official flows (row 20) made up the difference, reflected at least in part by massive currency market intervention that year. The table also indicates that among the most volatile components of capital flows are long-term inbound capital, a phenomenon that largely reflects American investors moving in and out of the Japanese securities market.

While the data in Figure 2 and the table are comprehensive, even they do not give the complete picture, particularly from the Japanese perspective. Since they are expressed in dollars the data adequately show capital flows to the United States and elsewhere but do not demonstrate the importance of trade or capital flows to the Japanese economy. If the yen were to depreciate, for example, a given dollar-denominated capital flow would require more yen to finance. Similarly, a given value of exports as measured in dollars would be larger in yen terms. Nor do these data give a feel for net foreign transactions relative to the rest of the Japanese economy.

Japan's current account measured in yen resolves these differences when expressed as a percentage of nominal GNP (see Figure 3). From the Japanese perspective this may be the most meaningful measure of the net impact of international commerce on the Japanese economy. A comparison of Figure 1, which reflects the impact of Japanese trade on the U.S. economy through the prism of the most widely used U.S. measure (the bilateral trade imbalance), with Figure 3 reveals striking distinctions after 1986. Until that year both standards showed growing imbalances. But the U.S. measure, which peaked in 1987, recorded a drop of only 27.9 percent between then and 1990. From the Japanese perspective its current account surplus relative to GNP shrunk 71.4 percent from a 1986 peak. In other words, in recent years American policymakers are likely to believe that progress has been minimal, while Japanese policymakers can be convinced that their economy's external surplus is practically a thing of the past.

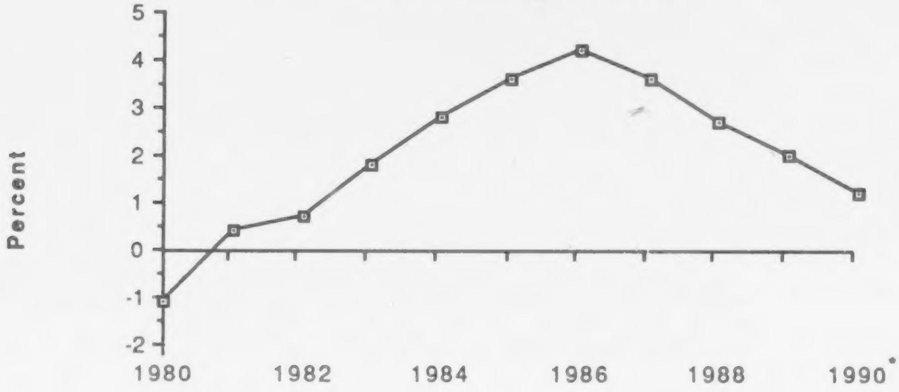
Japan's Balance of Payments, 1986-90

(in millions of dollars, IMF value basis)

		1986	1987	1988	1989	1990(p)
1.	Exports (f.o.b.)	$205,591	$224,605	$259,765	$269,570	$280,177
2.	Imports (f.o.b.)	112,764	128,219	164,753	192,653	216,321
3.	Trade Balance (1)-(2)	92,827	96,386	95,012	76,917	63,856
4.	Services	-4,932	-5,702	-11,263	-15,526	-22,587
5.	Transfers	-2,050	-3,669	-4,118	-4,234	-5,477
6.	Current Account (3)+(4)+(5)	85,845	87,015	79,631	57,157	35,792
Long-Term Capital Outflow						
7.	Direct Investment	14,480	19,519	34,210	44,130	47,941
8.	Trade Credits	1,836	535	6,939	4,002	-744
9.	Loans	9,281	16,190	15,211	22,495	22,190
10.	Securities	101,977	87,757	86,949	113,178	39,681
11.	Other	4,521	8,829	6,574	8,313	11,572
	(7)+(8)+(9)+(10)+(11)	132,095	132,830	149,883	192,118	120,640
Long-Term Capital Inflow						
12.	Direct Investment	226	1,165	-485	-1,054	1,750
13.	Trade Credits	-40	-1	-18	-9	-2
14.	Loans	-34	-119	-82	17,813	39,112
15.	Securities	545	-6,081	20,298	85,144	34,653
16.	Other	-63	1,334	-760	978	1,672
	(12)+(13)+(14)+(15)+(16)	634	-3,702	18,953	102,872	77,185
17.	Net Long-Term Capital Outflow	131,461	136,532	130,930	89,246	43,455
18.	Net Short-Term Capital Inflow	-1,609	23,865	19,521	20,811	21,367
19.	Errors and Omissions	2,458	-3,893	2,796	-22,008	-20,938
20.	Net Increase in Gold and Foreign Exchange Reserves	15,729	39,240	16,183	-12,767	-7,842
21.	Net Increase in Liabilities of Authorized Foreign Exchange Banks and Other Transactions	60,496	68,785	45,165	20,519	-608
22.	Net Long- and Short-Term Capital Flows, Errors and Omissions and Official Capital and Gold Flows = Current Account (6) (17)+(20)-(18)-(19)-(21)	85,845	87,015	79,631	57,157	35,792

Source: Calculated from Bank of Japan data

Figure 3: Japan's Current Account as Percentage of GNP



*Preliminary

Note: Yen-denominated current account divided by nominal GNP.

Sources: Bank of Japan and Economic Planning Agency

However, all the data shown in Figures 1-3 still are not enough, even taken together, to address a question frequently raised about Japan's trade. When the yen virtually doubled in value against the dollar between 1985 and 1988, one might have expected Japanese exports to become more expensive and imports cheaper, resulting in a dramatic decline in Japan's current account and other external balances to the point where some series might turn negative, as had been the case in 1980. Yet many analysts have concluded from a perusal of trade statistics and current account data that the imbalances budged relatively little in response to the yen's appreciation; even Figure 3 shows that the current account imbalance in 1990 involved a larger percentage of the Japanese economy than it had between 1980 and 1982.

These analysts argue from these statistics that Japanese exports and imports are unresponsive to changes in the exchange rate. Some critics take the argument a step further, suggesting that, since exchange rate changes do not work to reduce Japan's surplus, Washington should try other means, including inducing Tokyo to take market-opening measures or to engage in managed trade. As noted above, however, such measures will not affect trade imbalances in the absence of changes in international capital flows, and they are unlikely to change without deviations in relative interest rates.

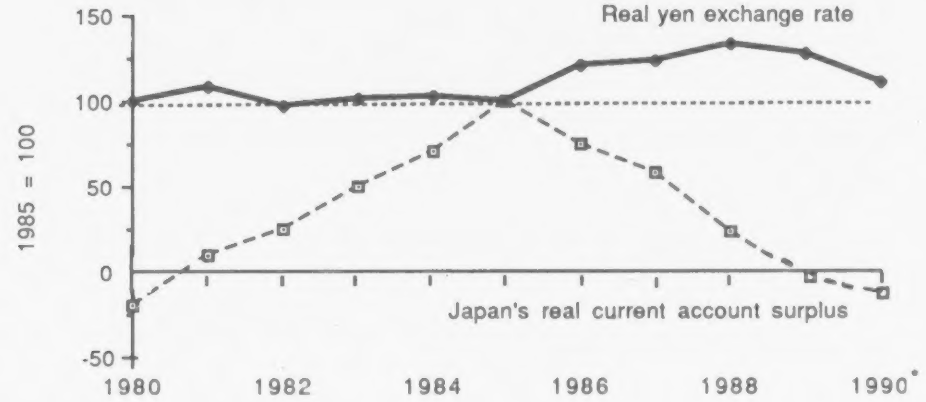
In short, a demonstration that exchange rates do influence export and import volumes will prevent these critics from pursuing a logical path that would be incorrect in any case. Fortunately, their initial premise is also wrong; Japanese exports and imports do respond to exchange rate changes.

Their error is superficial consideration of the statistical nature of external imbalances. All the data presented up to now have been expressed in value (price times volume) terms. Drawing inferences about volumes of exports and imports from value data alone is inappropriate if prices also change, which clearly is what happens when currency values shift. For example, as the yen appreciated from 1985 to 1988, Japanese companies attempted to maintain their yen-based prices, other factors equal, implying that prices expressed in dollars rose. Even if competitive pressures prevented dollar prices from rising as much as they might have, such prices were not completely stable either. Hence, even if the dollar value of exports increased, the volume of exports might have declined.

In addition, the yen's appreciation could be expected to work its magic on reducing export volumes only if the currency change resulted in Japanese exporters having to raise their prices more than their American and European rivals. With overall inflation less in Japan than in most of its trading partners, however, exporters there most likely would have enjoyed increased global competitiveness in the absence of the yen's appreciation. For this and other reasons the yen's appreciation is inappropriately expressed if not adjusted to reflect Japan's greater price stability; only to the extent that the yen appreciated more than the difference in inflation rates between Japan and its trading partners could meaningful appreciation be said to have taken place.

Figure 4 sorts out the effects of price changes for exports and imports and in relative rates of inflation. One line shows an International Monetary Fund measure of the yen's real trade-weighted exchange rate. The effect of taking inflation out of the yen's value is to reduce dramatically the Japanese currency's apparent appreciation. Its peak value in 1988 was 33.2 percent above the 1985 level. By 1990 it was practically back to its 1981 value although still 11.4 percent ahead of 1985.

Figure 4: Real Trade Balances and the Real Yen



*Preliminary

Sources: Economic Planning Agency and International Monetary Fund

The second line shows exports and imports adjusted for price changes, with 1985's real current account surplus scaled to represent 100. During the early 1980s the surplus measured this way increased despite the yen's nearly stable real value. In part this reflected the recovery, particularly in the

United States, from the recessionary conditions of 1981 and 1982. The real appreciation of the yen that began in 1985, however, reversed the course of the price-adjusted current account, which took on a negative value in 1989, one year after the real value of the yen peaked. The real deficit continued to grow in 1990 in the face of the yen's depreciation.

The lesson of Figure 4 is that exchange rates matter by affecting export and import quantities. Changes in export and import quantities alone since 1985 would have been able to throw Japan's external accounts into deficit. The fact that this did not happen for measures based on dollars is attributable to the higher dollar-denominated prices exporters were able to charge their overseas customers; yen-denominated measures remained in surplus, too, but as a result of the lower prices Japanese companies paid for imports expressed in yen.

Conclusion

A nation's external account measures are like the many rooms of a mansion, each serving a different purpose. The choice of appropriate statistics depends on the purpose to which it is put. In assessing Japan's trade performance, American critics often have chosen inappropriately, typically selecting too narrow a measure. Furthermore, the same critics often, by design or accident, use measures that cast Japan's trade performance in the least favorable light. Partly for this reason American and Japanese policymakers have developed quite different views about the extent of progress in reducing Japan's external imbalances.

The merit of trade statistics generally is open to serious question. It is not that the measures are poorly constructed; on the contrary, the statistics produced on both sides of the Pacific do their compilers proud, with Washington more than holding its own with Tokyo. However, all that good work may be unnecessary. After all, the government does not bother to measure the important trade between Texas and California, although it can provide excruciating detail on foreign trade with a relatively minor U.S. partner. Why, dollar for dollar, is international trade so much more important than domestic transactions? It is not, some critics suggest, and the government should stop wasting its effort. Just as California and Texas generally avoid trade disputes because no one knows the size of the imbalance, large savings in transpacific airfares, computer tape at the Bureau of the Census and headaches at the State Department and the Foreign Ministry could result if the numbers went uncollected. Those who make this suggestion contend that the only economic downside would be increased unemployment among the ranks of Washington's lobbyists and number crunchers.

Certainly, the way in which policymakers use external account statistics is an argument against their continued collection. As noted above, the presence of a trade imbalance between the United States and Japan says little about the openness of Japan's market. Hence, measures taken to open that market probably will not affect the imbalance. However, trade and current account numbers do cast a revealing spotlight on the extent of policymakers' failure to deal with the mismatch of domestic savings and domestic investment. While this mismatch may be beneficial if it leads to a capital inflow that enhances the competitive base of the recipient county, current account data do not provide a way of assessing how effectively the funds are used. If used for productivity-enhancing investment, the capital inflows could be beneficial, other factors equal. However, given the fact that the American and the Japanese imbalances of the 1980s arose largely from the swelling of this country's federal budget deficit, which was not a consequence of productive investment, then international surpluses and deficits can be viewed as undesirable from the U.S. perspective. As such they point to an American -- not a Japanese -- policy failure. To that extent current account imbalances are useful to calculate, their misuse by policymakers notwithstanding.

External imbalances may not mean much in terms of trade policy, but the underlying export and import levels still are important, primarily because the levels might be less than would be possible in the absence of trade barriers. California's trade with Texas does not need to be calculated because there is no reason to believe that either state is taking measures to restrict purchases from the other. If trade is less than what it might be, then unexploited opportunities exist, not just for firms to make money but for buyers to obtain better or cheaper goods and services. Identifying such situations is an important role for economists, policymakers and lobbyists.

For further information, contact Douglas Ostrom.

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JEI

REPORT

A Two-Part Report: A and B

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Japanese-Soviet Summit Yields No Accord On Northern Territories

After months of anticipation and recent weeks of shuttle diplomacy the April 16-19 summit in Tokyo between Soviet President Mikhail Gorbachev and Prime Minister Toshiki Kaifu came to an anticlimatic end with the two countries still at an impasse over Japan's claim to four Soviet-held islands northeast of Hokkaido. While the two leaders signed 15 agreements ranging from trade promotion to cultural exchanges, Messrs. Gorbachev and Kaifu were unable to use their marathon discussions to break the Northern Territories logjam and, in turn, pave the way toward conclusion of a peace treaty finally resolving World War II. Mr. Gorbachev optimistically forecast that Japan and the Soviet Union now can "take the first step [toward] a new relationship." Deep-rooted political and economic differences, however, may continue to impede progress in bilateral relations.

Both leaders fell short of accomplishing what they had intended. Mr. Kaifu wanted to secure return of the northern islands; Mr. Gorbachev sought a substantial commitment of Japanese economic assistance to facilitate perestroika, the opening of the Soviet Union to a more market-oriented, democratic society. After signing a joint communique at the resplendent Akasaka guesthouse marked the beginning of a new dialogue between Japan and the Soviet Union rather than a failure to resolve past conflicts.

Foreign Minister Taro Nakayama is expected to travel to Moscow in July to set the stage for a visit by Mr. Kaifu, probably in late summer or early fall. Some political analysts have proposed that the real success or failure of the Tokyo meeting will not be known until the two leaders meet again on Soviet turf. Lurking in the background for both leaders, however, are domestic threats to their tenure in office. Mr. Gorbachev is faced with secessionist pressures in the Baltic states and other domestic political minefields; if his Japan trip is viewed by Soviet power brokers as a misstep in his area of strength -- foreign policy -- he may be less willing to engage in bridge-building in future meetings. For that matter, Mr. Gorbachev may not even be hosting the next meeting. Likewise on the Japanese side. Most political commentators believe that Mr. Kaifu strengthened his hold on the premiership by standing firm with the Soviet leader. In the coming months, though, the prime minister's ruling Liberal Democratic Party colleagues may decide that a leader who has a strong domestic political base and is seen as more decisive would be better able to affect progress on Japanese-Soviet issues.

Barbara Wanner

Japan's Trade Surplus Rises In First Quarter

Winning streaks inevitably are broken, a condition also applicable to trends in Japan's trade imbalance. Those on both sides of the Pacific who felt a sense of triumph after seven straight quarters of a declining surplus in Japan's customs-clearance trade figures most likely are disappointed that the dollar version of this measure registered a 19.8 percent increase in the first three months of 1991 compared to 1990's initial quarter (see Table). While those hoping for a smaller surplus may have lost the latest round, their win-loss record still is pretty good in recent years; the latest figure represented the second-smallest first quarter surplus since 1986. Broader measures, such as the current account statistic, generally have shown more dramatic drops in Japan's external imbalance since peaking in the 1985-87 period than have the customs-clearance data, which cover only goods. (For details of various measures of Japan's external imbalance and comparisons with corresponding U.S. figures, see JEI Report No. 15A, April 19, 1991.)

As usual, the January-March 1991 outcome represented the net result of a number of conflicting trends. Most important was the appreciation of the yen; the Japanese currency was about 9.5 percent stronger against the dollar (using the average conversion rate for exports and imports) than a year earlier. This change, coupled with different pricing patterns among exporters and importers, appears to explain a substantial portion of the results. Exporters, for example, use the dollar as well as other currencies to price their products in foreign markets. (See JEI Report No. 38A, October 5, 1990 for details on currencies used to price exports and imports in Japan.) As the dollar fell in the first quarter, exports priced in yen or other currencies became more expensive in dollar terms. Importers, however, are far more likely to sign dollar contracts than are exporters; hence, changes in the value of the yen against the dollar did not lead to comparable changes in import values expressed in dollars. Since import and export volumes changed little relative to changes in

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$209,151	19.1%	$126,408	-2.4%	$82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1989	275,175	3.9	210,847	12.5	64,328
1990	286,948	4.3	234,799	11.4	52,149
1989: I	68,227	13.2	51,142	14.9	17,085
II	67,602	3.7	51,292	8.5	16,310
III	69,595	3.6	53,048	12.3	16,547
IV	69,751	-3.5	55,364	14.6	14,387
1990: I	66,705	-2.2	54,383	6.3	12,322
II	67,232	-0.5	53,954	5.2	13,278
III	72,189	3.7	56,547	6.6	15,642
IV	80,822	15.9	69,914	26.3	10,908
1991: I (p)	76,523	14.7	61,767	13.6	14,756

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y35,290	-15.9%	Y21,551	-30.7%	Y13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1989	37,823	11.4	28,979	20.7	8,844
1990	41,457	9.6	33,855	16.8	7,602
1989: I	8,705	12.9	6,516	14.6	2,189
II	9,222	13.0	6,997	18.2	2,225
III	9,911	11.0	7,547	20.2	2,363
IV	9,985	9.3	7,919	29.4	2,067
1990: I	9,766	12.2	7,941	21.9	1,825
II	10,449	13.3	8,392	19.9	2,057
III	10,651	7.5	8,364	10.8	2,287
IV	10,592	6.1	9,159	15.7	1,433
1991: I (p)	10,208	4.5	8,243	3.8	1,965

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		$80,456	23.3%	$29,054	12.6%	$51,401
1987		83,580	3.9	31,491	8.4	52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,953
1989:	I	22,726	14.4	11,599	15.0	11,127
	II	22,997	6.4	12,064	15.4	10,933
	III	24,117	4.6	12,462	16.8	11,655
	IV	23,347	-7.0	12,120	12.0	11,227
1990:	I	21,661	-4.7	12,753	9.9	8,908
	II	20,938	-9.0	12,861	6.6	8,077
	III	22,933	-4.9	12,729	2.1	10,204
	IV	24,790	6.2	14,025	15.7	10,765
1991:	I (p)	22,304	3.0	13,237	3.8	9,067

Japan's Trade with the United States in Yen Terms

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		Y13,564	-13.0%	Y4,918	-20.9%	Y8,646
1987		12,148	-10.4	4,582	-6.8	7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1989:	I	2,899	14.1	1,478	14.6	1,421
	II	3,139	16.0	1,648	25.9	1,491
	III	3,436	12.2	1,773	25.0	1,663
	IV	3,342	5.2	1,733	26.4	1,609
1990:	I	3,171	9.4	1,862	26.0	1,309
	II	3,254	3.7	2,000	21.4	1,254
	III	3,384	-1.5	1,885	6.3	1,498
	IV	3,249	-2.8	1,838	6.1	1,411
1991:	I (p)	2,978	-6.1	1,765	-5.2	1,213

currency values and since the volume of exports remains larger than that of imports, the dollar-denominated trade surplus showed an increase.

Similar reasoning also can be applied to the imbalance as expressed in yen. When measured using the Japanese currency, exports rose 4.5 percent in this year's first quarter compared to a 3.8 percent rise in imports. However, the volume of exports, which increased 5.9 percent, expanded more slowly than real imports, which were up 6.3 percent. Because the volume of both exports and imports went up more than their value expressed in yen, the price levels of each fell as stated in yen, with imports showing the larger drop. Exports exhibited relatively little change in value because they are priced in a variety of currencies, but import values expressed in yen showed a sharp drop because they usually are converted from dollars. Given the comparatively modest changes in volume terms, exports that were relatively stable in price combined with cheaper imports to produce a larger yen-based surplus.

Economic conditions at home and abroad during the first quarter also may have been a contributing factor to Japan's larger trade surplus. As the U.S. recession deepened and the price of imported oil rose above year-earlier levels, the surplus got a downward nudge from smaller export and larger import values than otherwise. At the same time, though, the Japanese economy's weakness during the first three months of 1991 as a consequence of uncertainty about the strength of export markets and the price of oil plus concerns about high domestic interest rates may have kept imports below levels they otherwise would have reached. Perhaps reflecting particularly weak economic conditions in the United States, the bilateral surplus increased less than Japan's worldwide imbalance. The surplus rose a scant 1.8 percent in dollars while actually declining 7.3 percent in yen terms.

The economies of Japan, the United States and other major trading nations are likely to figure even more prominently in the direction of international trade imbalances in coming months. Generally speaking, the weaker the economy the better its trade performance vis-a-vis its partners is likely to be. For example, in the not unlikely event that the Japanese economy remains sluggish while the U.S. economy recovers, Japan's trade surplus could widen this year, suggesting that the first-quarter results could be a harbinger. Even if the U.S. economy stays in the doldrums, rising exports from Japan to foreign markets outside the United States could lift the overall Japanese surplus. Those who would like to see further reductions in the surplus pin their hopes on the renewed strength of the Japanese economy, a development that would spur increased imports.

Douglas Ostrom

Spring Wage Drive Lags

This year's annual nationwide spring wage talks, or shunto, yielded few surprises, removing one cloud that might have darkened the country's economic outlook. As of April 15 bargaining had achieved for the average Japanese worker a 5.63 percent salary hike, adding Y14,515 ($107.52 at Y135=$1.00) to his or her monthly wages, which now average Y257,871 ($1,910.16). Last year's average increase was 5.94 percent. This is the first year since 1987 that the average wage increase has not surpassed the previous year's, a fact that domestic analysts welcomed. They argued that this moderate increase would reassure an inflation-sensitive central bank while providing a boost to workers' real incomes sufficient to keep consumer spending firm. Workers also made some headway on nonmonetary issues, such as a decrease in working hours, but employers successfully used the intensifying level of international competition to stave off large concessions.

According to data gathered by Nihon Keizai Shimbun, workers in only two industries managed to win bigger pay hikes in 1991 than last year (see Table). Truckers and other land transportation workers bargained for a 5.61 percent raise versus 5.34 percent in 1990, while their seaborne counterparts won an even thinner 0.08 percentage point increase over last year's 6.10 percent mark. At the other end of the spectrum workers in the information and software industry suffered a 1.36 point reduction in their 1991 wage gain -- the sharpest fall from last year's results -- but still won an above-average raise of 6.23 percent. The leisure industry led the way this year, giving its employees an average 7.12 percent hike, while the warehousing sector brought up the rear at 4.03 percent.

Many Japanese analysts had fretted that despite continuing economic growth unrealistic wage gains would shorten the current expansion's life span. The link between corporate profits and wage hikes was even more tenuous than in previous years. Toyota Motor Corp., Japan's largest motor vehicle maker and most profitable company, kept its unions to an even smaller hike this year, 5.52 percent, than last year (5.93 percent). Although the management of Honda Motor Co., Ltd. used the firm's current difficulties to bargain down wage gains from last year's 6.17 percent level, the result remained above Toyota's at 5.65 percent. Nippon Telegraph and Telephone Corp., which sets the pace in the fast-growing communications industry, held its wage increase to 6.03 percent compared to 6.37 percent last year. Even though booming demand might be expected to loosen the purse strings, steel companies managed to win pay concessions from workers.

Following a now traditional pattern, workers in nonmanufacturing jobs received bigger increases on average than people employed in the manufacturing sector -- 5.95 percent versus 5.47 percent. The difference probably is understated since data from the banking, insurance, securities, and consumer credit and leasing industries were not reported in the survey. The compensation disparity between the financial and the manufacturing sectors now is so great that an increasing number of science and engineering graduates are seeking entry-level positions at nonmanufacturing firms. According to the Ministry of Education, 62.6 percent of all engineering graduates from government-funded schools chose manufacturing careers in 1987 but only 56.7 percent did so in 1990. Over the same period graduates with engineering degrees signed up with financial institutions in greater numbers, rising from 4.3 percent to 10.5 percent. Many analysts agree that the lure of big paychecks in the financial sector is attracting more of the top science and engineering graduates.

To counter this trend manufacturers are improving fringe benefits, such as company housing and recreational facilities. They also are trying to rid themselves of an image as dirty and dangerous workplaces by investing heavily in robotics and worker safety. A major battleground, however, has developed over the average number of hours employees work a year. The fight is taking place on two fronts: a reduction in normal and overtime hours as well as an expansion in the number of paid holidays. While many leading Japanese firms

Midterm (April 15) Results of 1991 Spring Wage Negotiations

Industry	1990 (actual)		1991 (preliminary)		Monthly Wage	Average Worker Age (years)	Number of Firms
	Amount	Change	Amount	Change			
Manufacturing	Y13,885	5.79%	Y13,610	5.47%	Y249,219	35.1	774
Food	13,263	5.29	13,571	5.24	258,917	36.4	55
Textiles	13,891	5.88	13,509	5.53	243,734	37.0	48
Pulp and Paper	13,833	5.58	13,629	5.33	256,560	38.8	21
Chemicals	15,507	6.00	15,113	5.66	267,787	36.5	66
Pharmaceuticals	13,697	5.18	13,999	5.15	274,752	33.2	14
Petroleum	12,959	5.50	12,699	5.17	243,918	28.9	9
Rubber	13,950	5.50	13,531	5.17	264,201	39.7	14
Mineral Products	14,410	5.87	14,209	5.62	252,552	37.2	17
Steel	12,090	4.83	11,601	4.46	260,686	35.5	36
Nonferrous Metals	13,354	5.88	13,169	5.61	235,385	36.2	44
Nonelectric Machinery	14,451	6.02	14,169	5.69	249,634	36.7	143
Electric Machinery	13,685	5.95	13,350	5.58	238,949	33.4	126
Shipbuilding	13,896	5.41	13,947	5.22	267,878	40.4	10
Automotive	14,016	5.95	13,660	5.57	245,240	34.8	90
Other Transport	14,187	5.77	13,888	5.52	251,534	38.2	10
Precision Equipment	15,792	6.02	15,315	5.72	267,678	33.7	33
Business Machines	17,151	6.24	15,840	5.80	274,158	31.5	7
Printing	13,248	6.42	12,114	5.69	212,435	31.8	5
Other	14,506	6.00	14,411	5.86	247,739	35.9	26
Nonmanufacturing	16,294	6.24	16,308	5.95	275,028	36.3	249
Fishing	12,897	5.14	12,201	4.78	255,564	33.5	8
Mining	12,699	5.27	12,745	5.09	249,554	31.0	2
Construction	18,106	6.40	18,003	6.07	294,986	37.2	29
Real Estate	13,475	6.13	10,696	5.76	184,889	30.2	3
Commerce	14,653	6.75	14,211	6.33	224,387	32.3	24
Large Retailers	14,834	6.65	15,092	6.48	232,331	30.8	35
Small Retailers	14,363	6.92	14,177	6.55	216,637	27.7	9
Rail and Bus	16,222	6.17	16,280	5.93	274,445	39.9	46
Ground Transport	13,041	5.34	14,316	5.61	254,701	35.2	8
Sea Transport	13,255	6.10	13,668	6.18	220,690	35.5	2
Air Transport	17,841	5.05	17,084	4.60	388,965	27.9	5
Warehouse	11,460	4.80	9,744	4.03	242,792	33.6	10
Communications	16,940	6.35	16,956	6.02	281,407	38.9	2
Electricity	15,900	5.69	15,600	5.30	293,635	33.7	10
Gas	15,624	5.77	15,310	5.46	280,386	36.5	9
Hotel and Travel	17,353	6.70	18,388	6.45	283,199	33.5	12
Other Leisure	19,133	7.48	19,077	7.12	267,235	28.4	2
Mass Media and Advertising	24,432	6.66	23,833	6.24	388,862	38.5	20
Information and Software	16,290	7.59	14,176	6.23	227,134	28.6	8
Other	14,893	5.87	15,152	5.79	262,879	35.9	5
Average	14,702	5.94	14,515	5.63	257,871	35.5	1,023

Source: Nihon Keizai Shimbun, April 19, 1991.

have agreed to the Ministry of Labor's lofty goal of reducing total annual working hours from the current level of between 2,100 to 2,200 to a 1993 range of 1,800 to 1,900 hours, few concessions were won in this year's talks. Although NTT set a limit on overtime hours of 450 a year, the impact will be limited since the average overtime logged by NTT employees is only 147 hours. Other major firms fended off commitments to reduce working hours. Instead, many granted more liberal policies on paid holidays. Several firms, for example, agreed that whenever a holiday falls on a Saturday they would make the preceding Friday a paid day off. Other companies said they will institute a policy of mandatory holidays for birthdays and other special occasions. Mandatory time-off policies are expected to address the disparity between the number of paid holidays made available and the number actually taken; electric utility workers, for example, take off an average of 11.5 days out of a possible 20.

From the standpoint of the entire economy 1991's shunto results are good news. The Bank of Japan had hinted that it would consider excessive wage hikes a spur to inflation. Many businesses already suffering from BOJ's tight monetary policy took this threat seriously and hardened their positions. At the same time statistics showing that overall Japanese economic growth is slowing served as a floor preventing management from being too stingy on wage gains. Consumer spending accounts for well over half of economic activity, and a solid real wage gain will help keep the strings on pocketbooks loose.

Jon Choy

Eastern Europe Poses Dilemma For Japan

Japan took another step toward broadening the scope of its role as the world's leading donor of development assistance when Tokyo announced April 15 that it would provide roughly Y850 million ($6.3 million at Y135=$1.00) to establish a fund for Eastern Europe within the European Bank for Reconstruction and Development. Finance Minister Ryutaro Hashimoto told the first meeting of the EBRD that the proposed Japan-Europe Cooperation Fund would support the new institution's efforts to bolster economic reforms in the eastern bloc. Until recently Japan had little political or commercial interaction with Eastern Europe, but within the past year or so it has made a series of commitments to the region. One of these commitments, however, has been the cause of a dispute over debt reduction; the debate over this issue has shed light on Tokyo's attitudes toward development loans.

Established last year with the backing of more than 40 nations and agencies, the EBRD's $12 billion in capital was slated to come mainly from the European Community, with Japan and the United States both contributing 8.5 percent, or about $1 billion each. At the EBRD's mid-April inaugural meeting in London Mr. Hashimoto confirmed that Tokyo is willing to extend active financial backing to Eastern Europe through the bank. Referring to Japan's own reconstruction after World War II, Mr. Hashimoto said his country is certain Eastern Europe can achieve economic stability through political and economic reforms with the support of the development bank.

The main objectives of the proposed Japan-Europe Cooperation Fund are to scout out projects for EBRD funding and to develop human resources in Eastern Europe. Prior to the EBRD meeting Japanese officials characterized the fund as

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NO. 17A May 3, 1991

JAPAN'S FISCAL POLICY: WHEN THE GOING GETS TOUGH . . .

Summary

Having achieved in FY 1990 the objective of eliminating new issues of deficit-financing bonds, Japanese government planners are reorienting fiscal policy to meet new challenges and priorities. Just as Japanese fiscal policy embarks in new directions, however, slower domestic economic growth and growing foreign policy demands appear ready to complicate, if not upset, Tokyo's carefully laid plans.

Overview

For most of FY 1990, which ended March 31, Japan's fiscal policy followed the path of selective austerity laid down at the beginning of FY 1987; this paired moderate increases in discretionary general account spending with a rapid reduction of new borrowing. This combination of stimulative and contractive measures has limited the public sector's role in overall economic growth in recent years. Nevertheless, Tokyo still is able to influence economic activity in specific areas by selectively reallocating general account funds. The supportive role of the Fiscal Investment and Loan Program continues to grow under the dual demands of greater public works spending and bigger foreign aid budgets.

General Account Expenditures - Since FY 1986 the clamp of fiscal austerity has been loosened gradually and fitfully as can be seen from Table 1. The overall growth of general account spending has outpaced the nominal expansion of gross national product for the last four fiscal years and almost surely will do so again in FY 1991. As Table 2 shows, however, much of the growth has come from mandatory payments -- transfers to local governments and interest costs on the national debt. The expansion of discretionary outlays has been moderate, surpassing the rate of inflation but falling short of overall economic growth since FY 1987. (Japan's contribution to the multinational forces allied against Iraq makes FY 1990's revised budget an exception.) While the initial increase slated for FY 1991 general account spending is below that of the previous year (6.2 percent versus 9.7 percent), discretionary spending is set to rise faster in the current fiscal year than initially planned in FY 1990 (5.3 percent compared to 3.7 percent). Thus, the "austerity/expansion" spending pattern initiated in FY 1987 continues.

One tool for austerity went into effect in FY 1986. As part of its campaign to balance the budget, the Ministry of Finance that year implemented an informal rule under which every government agency faced a cap on capital outlays and a requirement to reduce by 10 percent its current operating costs. The patchwork of increases and decreases over time for the various expenditure categories in Table 1 indicates the success or failure of hard budget negotiations between MOF and other agencies in every budget cycle. The Finance Ministry has proved tough but not inflexible: no budget item has been cut consistently. Nevertheless, few items have escaped MOF's rule unscathed.

Another source of variation in funding has political roots. Defense and foreign aid have enjoyed a charmed life because of strong foreign pressure for greater Japanese spending in these areas. Defense outlays have expanded by an average annual rate of 6 percent, while economic cooperation has been granted increases of 8 percent or more since FY 1987. When political aegis has waned, sharp funding shifts have resulted. Agricultural price supports, for example, were safe until domestic and outside pressures in the late 1980s led to cutbacks in funding. Energy programs, out of favor in the mid-1980s, have recaptured Tokyo's attention following the Persian Gulf crisis. While foreign pressure may tip the balance of budget negotiations in a category's favor, it is not sufficient to guarantee growth. The budget for public works, for example, shows large swings despite steady American pressure on Tokyo to spend more for roads, bridges and other infrastructure.

The projected leap in the cost of servicing the national debt in the current fiscal year is good news in disguise. The first real fruit of Tokyo's decade-long battle to balance the budget occurred in FY 1990 when debt service showed an initial jump of 22.5 percent over the previous year. Although FY 1991's projected increase of 10.8 percent is well below the year-earlier increase, the true interest payment component is expected to rise moderately for the second year in a row to about Y13 trillion ($96.3 billion at Y135=$1.00). The excess allocation, a little under Y3 trillion ($22.2 billion), will be used to reduce the huge amount of outstanding national bonds.

Japan's nearly $9 billion contribution to the U.S.-led multinational forces that ended Iraq's occupation of Kuwait provides a unique twist to both the FY 1990 and the FY 1991 budgets. The majority of funds for the contribution were appropriated in FY 1990 via a second supplementary budget, but the political pact that ensured passage of the controversial package stretched into FY 1991. The initial budgets for defense spending, reserves and administrative

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expenses in the current fiscal year were cut sharply to help fund the support package. The cuts were unusual because they were made after, rather than before, the cabinet approved the FY 1991 spending plan. (The budget normally is transmitted to the Diet immediately after cabinet approval.) The separation of an expenditure and its financing provisions into two fiscal years also is highly unusual, particularly in this case where at least part of the revenue to fund the outlay is to be collected well after the expenditure. To prevent a skewed analysis of budget trends, MOF has tried to keep the Persian Gulf contribution and its related funding measures separate from standard appropriations.

General Account Revenues - The revenue plan shown in Table 3 shows that, for the second year in a row, the government will finance operating expenses out of taxes and other revenue sources and borrow only to fund capital expenditures. Eliminating new issues of deficit-financing bonds became a target of fiscal policy in 1982, and the downward trend of deficit bond issues since FY 1986 is clear. Either extraordinary demands for funds, such as for the Persian Gulf situation, or lower economic growth (and therefore lower tax revenue growth), or both, may force the government to reassess its firm stand against borrowing to fund current outlays.

MOF has been less successful in achieving another goal, reducing the role of direct taxes in the composition of revenues (Table 3). Direct taxes, which generated 54.5 percent of all receipts in FY 1987, are expected to account for 66.9 percent of total revenues in FY 1991. Fiscal analysts feel that individual and corporate income taxes concentrate the tax burden unfairly. Specific indirect taxes can be targeted with greater precision and have less apparent psychological impact on taxpayers than direct levies, they say.

Until last year the strength of the Japanese economy was the major reason direct taxes continued to provide an increasing proportion of revenues; corporate taxes, in particular, expanded much faster than the government anticipated, thanks to buoyant demand at home. But a close look at Table 3 shows that revenues from the controversial consumption tax, which was supposed to reverse the increasing reliance on direct taxes, continue to run well below projected levels. According to the Ministry of Finance, consumption tax collections for the first eleven months of FY 1990 reached merely 47.6 percent of the year's projected total of Y4.9 trillion ($36.3 billion). Although this is a distinct improvement over FY 1989, when collections for the same period came to only 16.9 percent of the estimated annual total, MOF analysts point to continued difficulties enforcing the tax and to loopholes for smaller firms as the causes of the shortfall. Reforming the tax has lost its political heat over the two-plus years of its existence but remains a bone of contention between the ruling Liberal Democratic Party and opposition parties (see JEI Report No. 15B, April 19, 1991).

Table 3 also indicates that MOF is making little progress toward addressing questions of tax equity in the FY 1991 budget. Individuals instead of businesses again are expected to bear more of the tax burden, a development counter to the consumer-oriented policies advanced by the government in the late 1980s. Personal income taxes are charged with providing 54.7 percent of direct tax revenues in FY 1991, up from the most recent low of 46.7 percent in FY 1988 and just under FY 1986's figure of 55.6 percent. At the same time the share of corporate taxes, which contributed 48.8 percent of direct tax revenues in FY 1988, is projected to fall in FY 1991 to 40.9 percent because of the slowing economy.

The forecasts for FY 1991 also show that individuals paying self-assessed income taxes are expected to contribute less to personal income tax revenues than in FY 1990 -- 21.9 percent versus 24.9 percent. Conversely, people having taxes withheld will see their share rise from 75.1 percent to 78.1 percent. Despite a projected 6 percent drop in FY 1991 withholding revenue, bureaucrats and politicians are acutely aware that the average wage and salary earner already despises a tax system that allows the self-employed (politically powerful farmers, small shop owners and professionals among them) to avoid taxes.

Fiscal Investment and Loan Program - Japan's FY 1991 capital budget will set a record for overall spending for the sixth straight year (see Table 4). Outlays will amount to more than one-half (52.3 percent) of initial general account spending for the third straight year. It should be noted, however, that FILP expenditures in the current fiscal year probably will fall below the 50 percent mark when the supplemental budget is taken into account, just as they did in the previous two fiscal years. Nevertheless, FILP spending in FY 1991 once again will grow at a faster rate than general account outlays after falling behind in FY 1990.

The allocation of FILP monies in FY 1991 reads almost like a carbon copy of FY 1990. Funds for housing and foreign aid continue to increase at a fast pace, an outgrowth of the government's commitment to increase Japan's social overhead capital and bolster help for developing countries. The fast-growing category of "cash management" also deals with the public works area since much of the money flows into special construction projects. Other public works-related spending categories -- social infrastructure, land conservation, roads and regional development -- show much more modest growth. Unlike last year only one category -- transportation and communications -- shows a cutback, and a severe one at that. Welfare-oriented spending received a major boost for the second straight year, in line with an expected increase in the number of senior citizens over the next decades.

An analysis of FILP funding sources reveals some interesting developments. First, the pipeline between the general account and the FILP budgets -- the Industrial Investment Special Account -- appears to have stabilized after being constricted for several years. MOF seems intent on holding to a minimum this transfer from the general account; this category now comprises less than 0.2 percent of total FILP revenues. In contrast, the role of funds controlled by the postal system is expected to expand sharply in FY 1991. Postal savings and life insurance monies will account for 40.4 percent of all FILP revenues in FY 1991, close to FY 1989's high of 40.8 percent and substantially ahead of FY 1990's pool, which accounted for 36.2 percent of revenues. Contributions to the government-run pension fund and other government trust monies will remain the single-largest source of FILP revenues in FY 1991 at 54.4 percent, although this is down slightly from FY 1990's 58.1 percent mark. Government control of the major sources of FILP funds does not assure stability. In fact, the FILP's funding structure will be greatly affected by MOF's advancing program of financial liberalization, which will inject profit motives into a system that traditionally has spurned them.

Something Old, Something New . . .

Able to claim success at addressing several long-standing fiscal goals, Tokyo has forged new ones:

- Balancing the Budget - A sharp decline in government borrowing and an associated effort to hold construction bond issues in check is obvious from Table 5. The total budget deficit as a proportion of general account expenditures shrank from a high of 35.4 percent in FY 1979 to just 10.5 percent in FY 1990, a figure that is based on revised budget numbers and that includes the special Persian Gulf appropriation. Particularly impressive progress in trimming the deficit has been made since FY 1987. MOF's new benchmark is to reduce total bond issues to less than 5 percent of overall general account revenues by FY 1995. Since borrowing is expected to account for only 7.6 percent of total revenues in FY 1991, this goal should be easily attainable.

- Reducing the Size of Public Debt - To reduce debt service costs (which take up fully one-fifth of general account funds) the Finance Ministry has begun to focus on reducing the outstanding national debt. The government's success at weaning itself from borrowing to finance current operations in the late 1980s plus robust economic growth during that period helped push down the ratio of outstanding debt to nominal gross national product. The FY 1986 high of 43.4 percent fell to 37.2 percent in FY 1990 (see Table 6). By appropriating extra money under the debt service line item (as it did in FY 1990 and FY 1991), MOF is attacking the problem directly by buying back bonds before the end of their 60-year limit.

Such an approach also will forestall new issues of refinancing bonds that otherwise would be needed to pay off maturing bonds issued in the 1980s. Refinancing bonds still are an improvement over the original notes, even though current interest rates are near the levels of the early 1980s. Tokyo saves about Y650 billion ($4.8 billion) over the life of a bond issue for every percentage point difference between the rate of return on the original bond and the refinancing bond that replaces it.

- Fiscal Austerity - MOF would like to restrain the growth of overall government spending to less than the rate of nominal GNP expansion. Increases in nondiscretionary spending are likely to keep this goal out of reach. While the mountain of outstanding debt eventually may be whittled down to the point where debt service costs can be reduced, the other main component of nondiscretionary spending -- transfers to local governments -- is mandated by law and reacts only to the growth or shrinkage of tax revenues. Booming central government tax revenues in the late 1980s meant that more had to be funneled back to local authorities. Technically it is possible for Tokyo to adjust the revenue-sharing formula, but such a move also is politically unthinkable. After varying degrees of austerity throughout the 1980s, it is not clear how much more can be pared from such budget areas as administrative costs before government services begin to suffer.

- Public Works Spending - As specified in the Structural Impediments Initiative talks with the United States, Tokyo agreed to budget Y430 trillion ($3.2 trillion) for public works spending over the FY 1991-FY 2000 period, a figure calculated to boost the ratio of public works outlays to projected GNP to over 7 percent (see JEI Report No. 26B, July 6, 1990). The public investment spending target for the next decade represents a sharp increase over the Y274 trillion ($2 trillion) spent during the last 10 years. To achieve the Y430 trillion goal, public works spending will have to grow about 6.1 percent annually. Viewed in terms of the 4.75 percent average annual expansion predicted in the government's current five-year economic plan (covering FY 1988 through FY 1992) and the past decade's average annual increase of 1.2 percent, the magnitude of Japan's challenge becomes clear. Accordingly, the Finance Ministry submitted along with the FY 1991 budget a revised five-year public works spending plan that shows solid increases in all categories (see Table 7).

- Budget Practices - The private sector long has urged the government to eliminate budget structures that hide the true size of the deficit and generally make the fiscal blueprint hard to read. The general account budget, FILP and a host of special accounts are woven into an intricate web of financial flows. In some cases it is as if money disappears into a special account only to reemerge years later when it is needed. Or funds appear to flow from an account without an apparent source of income. Funds from the sale of government-owned shares of Nippon Telegraph and Telephone Corp., for example, continue to be included in revenue calculations despite no sale having taken place since 1989. Essentially the government is borrowing from and lending to itself without explaining all the transactions to outsiders. Better information will lead to better decisions, at least from the private sector's point of view.

- Financial Liberalization - Tokyo's program to restructure domestic financial markets poses many tough questions. Deregulation of interest rates, for example, probably will push up the average cost of new government bond issues and the refinancing of old ones. The restructuring of the postal savings system, which eventually must become part of the reform effort, will force major changes in FILP funding.

- Pension Fund Reform - Perhaps more important than changes involving the postal savings system are revisions to government pension and trust funds, which constitute the bulk of monies for FILP spending. If MOF's Trust Fund Bureau must earn higher returns to remain competitive with private trust funds, for example, FILP projects increasingly may become unattractive investments.

- Special Nontax Revenues - Japanese fiscal planners cannot continue to count on the revenue windfall from the sale of government-held shares of what formerly were public monopolies. Since FY 1988 sales of NTT shares have been penciled in to add an extra Y1.3 trillion ($9.6 billion) a year to public works spending, but public disenchantment with high-priced shares and volatile equity markets have forced the government to postpone new offerings or accept much lower prices (see JEI Report No. 45B, November 30, 1990). Moreover, in the long run the limited number of shares the government owns or is planning to sell ultimately eliminates this revenue source. MOF has no concrete plans on how to replace these revenues.

- Special Funding Needs - Although no reasonable planner wants situations like the Persian Gulf crisis to become regular occurrences, the need for special appropriations likely will become a standard feature of Japanese fiscal planning as Tokyo accepts greater international responsibilities, particularly ones related to global economic development. MOF and the ruling Liberal Democratic Party had to pull out all the stops to find a politically acceptable way to fulfill Japan's pledge to provide nearly $9 billion more to assist its allies' efforts in the Persian Gulf. The one-shot solution included drawing down emergency reserve funds from Y150 billion ($1.1 billion) to just Y200 million ($1.5 million). Other recent pledges of support have gone for Eastern Europe's reconstruction, increased aid to Latin America and economic assistance to strife-torn Asian nations.

. . . Something Borrowed -- And MOF's Blue

As is the case with most budget makers, MOF's primary concerns relate to income not outlays. The ministry's predicament is highlighted by several recent developments.

Thanks to the second-longest postwar economic expansion, tax revenues exceeded the Finance Ministry's expectations for several years in a row in the second half of the 1980s. In FY 1990, however, the good times came to an end when equity markets tumbled and corporate profits stagnated. According to MOF data, receipts from personal income taxes have been only moderately below expectations. Far below projections have been the take from corporations, securities transactions and the 3 percent consumption tax. Responding to the revenue shortfall, MOF asked government agencies in mid-April to freeze a larger-than-normal percentage of administrative costs from the very start of the fiscal year. Under past informal austerity guidelines the ministry had requested that supplementary budget requests, which cover the final quarter of the fiscal year, reflect a freeze of 7 percent of every agency's administrative expenses. The percentage for FY 1991 will be set sometime in May when revenue figures for full-year FY 1990 are known. While such steps certainly will help, only so much ink can be squeezed from the budget before essential functions are impaired.

The government's attention, therefore, has turned to the revenue side of the budget equation. As is usually the case, however, nonrevenue concerns have a significant impact on tax questions. For example, the cabinet's proposed tax changes for FY 1991 all will reduce tax receipts but promote other goals, such as encouraging families to have children or helping first-time home buyers. Nonfinancial considerations actually are the dominant features of tax questions currently being debated in Japan.

- Land Tax Reform - The government expects to win with surprising ease Diet approval of a package of new land taxes that will go into effect as of January 1, 1992. In the first year of operation property owners will pay a tax of 0.2 percent of the assessed value of holdings worth Y1 billion ($7.4 million) or more, with the rate rising to 0.3 percent the second year. To make the bill politically acceptable numerous caveats were attached, such as: the tax rate cannot be revised for five years; small businesses (defined as companies capitalized at less than Y100 million or $740,740) will be exempt if their property is worth less than Y1.5 billion ($11.1 million); parcels with an assessed value of less than Y30,000 per square meter ($20.65 per square foot) are exempt; and any property used for public purposes (such as hospitals and schools) also will be exempt. Critics contend that these loopholes will limit the new tax's scope to about 50,000 individual and corporate taxpayers and thus will generate only about Y150 billion ($1.1 billion) a year in revenue. To win support for the bill, the LDP attached an appendix calling for a review of the tax after three years and promising a cut in income taxes. Opposition parties, which criticized the bill as being soft on business, are likely to support it in the upper house since its purported goal is to address inappropriate land use (see JEI Report No. 28A, July 20, 1990).

- Consumption Tax Reform - The 3 percent consumption tax created a political firestorm when the LDP tried to introduce it in 1988. Capitalizing on popular disdain for the tax, opposition parties held up passage of the general account budget in 1988, 1989 and 1990. The first two years' impasses failed to prevent implementation of the tax, so the opposition tried last year to drastically reform it. Processing of the current fiscal year's budget, in contrast, was almost completely free of acrimony on this issue. Although debate over Persian Gulf assistance overshadowed all other issues, the LDP and opposition parties tacitly had agreed to put reform of the consumption tax on the back burner for this year (see JEI Report No. 15B, April 19, 1991).

As popular interest in the tax has waned, so has the determination of opposition parties weakened. This does not mean that the issue simply will vanish. On the contrary, the Social Democratic Party of Japan announced in late April its ideas for amending the tax. These include: requiring businesses to file tax reports quarterly rather than biannually; further differentiating tax rate categories from the current two (which make 80 percent or 90 percent of sales subject to the tax) to four; reducing the tax's burden on selected groups; and replacing lost revenues by broadening commodity taxes. The proposed rate change would involve taxing between 60 percent and 90 percent of the goods and the services subject to the tax; depending on the type of business, increments would come in 10 percentage points. The SDPJ hopes to introduce a reform bill in the current Diet session, which ends May 8. The LDP has yet to respond to the proposal, but there are grounds for compromise since the measure is similar to the LDP's reform suggestions.

Conclusion

The rapid elimination of borrowing to finance current government operations underscores the Finance Ministry's strong position within the government. Fiscal austerity has not been a popular policy with other ministries or with many influential domestic political groups and foreign allies. Yet, while pursuing a balanced general account budget, Tokyo has been able to expand financial support for defense and foreign aid. More demands are in the offing. Added in FY 1991 to MOF's already full slate of policy-related funding categories was Tokyo's SII promise to increase public works and raise the standard of living. Jousting between the LDP and opposition parties over tax issues may poke some holes in MOF analysts' fiscal plans but should not lead to major changes.

Complicating MOF's fiscal planning are forces beyond its control. Foreign pressure, financial market restructuring and unpredictable equity markets can upset carefully laid schemes. Perhaps the biggest headache is the apparent end of tax windfalls as the economy slows. Pressure from the private sector for the government to institute a stimulative fiscal policy has not yet developed, mainly because most observers feel the current slowdown is a result of a tight monetary policy, not a restrictive fiscal policy stance. If the economy continues to lose momentum, however, Tokyo may be forced to further bolster public works spending, putting MOF's position on new borrowing to the test. Even if no clamor arises for the government to stimulate the economy through higher spending, the prospective drop in tax revenues is sure to pressure MOF's existing budget plans. Having clung for so long to the totem of fiscal austerity, it is not clear how the ministry will respond to a new economic and political environment.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

Table 1: Japan's General Account Expenditures (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991**	
Total Expenditures	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	69,651.2	5.0%	Y70,347.4	6.2%
Social Security	10,321.8	2.3	11,801.4	14.3	12,474.2	5.7	11,544.6	-7.5	12,212.2	5.1
Public Assistance	1,105.2	-0.5	1,062.0	-3.9	1,080.6	1.8	1,050.8	-2.8	1,074.1	-3.1
Social Welfare	2,033.2	2.8	2,146.3	5.6	2,309.7	7.6	2,446.8	5.9	2,591.6	7.7
Social Insurance	6,310.2	2.8	7,732.3	22.5	8,203.4	6.1	7,204.8	-12.2	7,599.6	5.6
Health Services	512.3	3.0	500.7	-2.3	526.4	5.3	561.8	6.7	608.6	8.9
Unemployment Compensation	361.0	-1.8	360.2	-1.2	354.1	-1.7	280.5	-20.8	338.4	-2.5
Education and Science	5,063.7	3.6	4,982.0	-1.6	5,075.3	1.9	5,359.4	5.6	5,394.4	5.5
Compulsory Education	2,392.9	-0.9	2,463.5	3.0	2,475.5	0.5	2,642.6	6.8	2,638.2	6.2
Transfer to School Account	1,180.1	8.9	1,124.4	-4.7	1,184.8	5.4	1,264.3	6.7	1,265.9	5.5
Science and Technology Promotion	473.5	24.0	426.6	-9.9	453.9	6.4	474.2	4.5	507.4	6.7
School Facilities	354.6	1.3	283.3	-20.1	262.7	-7.3	244.3	-7.0	248.6	1.9
School Aid	580.9	0.9	601.0	3.5	615.4	2.4	650.3	5.7	647.6	3.6
Student Loans	81.7	1.5	83.3	2.0	83.0	-0.4	83.7	0.8	86.7	3.9
Public Works	7,428.0	6.9	6,683.0	-10.0	7,398.9	10.7	7,013.2	-5.2	6,589.7	6.1
Erosion and Flood Control	1,221.9	10.9	1,059.4	-13.3	1,080.6	2.0	1,087.3	0.6	1,146.9	5.6
Road Improvement	1,983.8	8.6	1,744.1	-12.1	1,782.6	2.2	1,789.2	0.4	1,900.0	6.3
Harbors and Airports	563.7	9.0	497.1	-12.8	511.5	2.9	515.0	0.7	544.9	5.9
Housing	964.4	2.6	930.3	-3.5	1,539.2	65.5	930.9	-39.5	808.4	5.8
Social Infrastructure	1,106.1	11.8	942.6	-14.8	954.9	1.3	957.4	0.3	1,034.5	8.1
Agricultural Infrastructure	963.7	8.7	852.4	-11.5	867.8	1.8	870.5	0.3	909.8	4.6
Forestry and Industrial Water Supplies	181.2	6.3	163.0	-10.0	169.1	3.7	157.8	-1.5	165.8	5.1
Disaster Reconstruction	431.6	-14.3	483.8	12.1	482.3	-0.3	694.7	44.0	68.2	2.2
Reserves	11.8	3.6	10.4	-11.9	10.9	4.8	10.6	0.2	11.2	5.3
Pensions	1,895.6	2.5	1,879.8	-0.8	1,855.7	-1.3	1,837.4	-1.0	1,808.4	-1.6
Civil Servants	122.2	0.7	118.1	-3.4	111.8	-5.3	107.8	-3.6	104.7	-2.9
Veterans	1,606.9	2.8	1,599.0	-0.5	1,588.5	-0.7	1,580.5	-0.5	1,560.8	-1.2
Other Pensions	157.6	1.1	154.4	-2.0	147.4	-4.5	141.0	-4.3	134.7	-4.6
Administrative Costs	8.9	-14.3	8.4	-5.6	8.0	-4.8	8.0	-0.2	8.1	1.7
Local Finance	11,086.2	13.9	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,974.9	4.6
Local Allocation Tax	11,086.2	13.9	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,974.9	4.6
Interest Support and Special Grants	0.0	00	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Debt Service	11,851.4	11.1	12,030.7	1.5	12,089.8	0.5	14,449.3	19.5	15,834.3	10.8
Defense	3,507.8	5.1	3,728.3	6.3	3,969.9	6.5	4,254.1	7.2	4,287.0	3.1
Economic Cooperation	661.3	10.1	714.4	8.0	750.6	5.1	802.0	6.8	845.9	7.8
Small Business Assistance	263.2	16.6	257.6	-2.1	240.5	-6.6	240.9	0.2	195.0	0.3
Energy Support	496.8	-12.9	458.4	-7.7	546.1	19.1	547.1	0.2	592.1	8.1
Food Agency Account	688.2	12.1	480.4	-30.2	459.2	-4.4	404.6	-11.9	373.2	-5.6
Miscellaneous	4,292.2	4.6	4,304.6	0.3	4,987.1	15.9	5,642.7	13.1	4,355.3	4.6
Salary Increase Reserve	—		—		—		—		135.0	
Reserves	200.0	0.0	200.0	0.0	200.0	0.0	325.0	62.5	150.0	-57.1
Industrial Investment Special Account	458.0	100.0	1,300.0	183.8	1,300.0	0.0	1,300.0	0.0	1,300.0	0.0
Persian Gulf Contribution***	—		—		—		—		300.0	

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1990.
***This amount actually was disbursed in FY 1990.

Source: Ministry of Finance

Table 2: Japan's Discretionary General Account Spending (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991**	
Total Expenditures	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%	Y70,347.4	6.2%
Minus										
Debt Service and Transfers to Local Governments	22,937.6	12.4	25,061.9	9.3	27,054.5	8.0	30,380.1	12.3	33,109.2	7.3
Equals										
Discretionary Spending	35,276.5	5.5	36,789.8	4.3	39,257.4	6.7	39,271.1	0.0	37,238.2	5.3

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1990.

Source: Ministry of Finance

Table 3: Japan's General Account Revenues (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991**	
Total Revenues	Y58,214.2	8.2%	Y61,851.7	6.2%	Y66,311.9	7.2%	Y69,651.2	5.0%	Y70,347.4	6.2%
Tax and Stamp Revenues	43,087.0	9.3	48,106.0	11.7	54,227.0	12.7	59,131.0	9.0	61,772.0	6.5
Direct Taxes	31,703.0	7.6	36,284.0	14.5	41,541.0	14.5	44,842.0	7.9	47,051.0	9.1
Income Taxes	16,188.0	-1.3	16,928.0	4.6	20,057.0	18.5	24,345.0	21.4	25,738.0	20.4
Withheld	12,303.0	-5.2	12,675.0	3.0	15,020.0	18.5	18,280.0	21.7	20,095.0	-6.0
Self-Assessed	3,885.0	13.8	4,253.0	9.5	5,037.0	18.4	6,065.0	20.4	5,643.0	13.6
Corporate Taxes	13,722.0	17.0	17,712.0	29.1	19,577.0	10.5	18,637.0	-4.8	19,267.0	-2.3
Inheritance and Gift Tax	1,793.0	32.7	1,644.0	-8.3	1,907.0	16.0	1,860.0	-2.5	2,046.0	0.0
Indirect Tax Revenues	11,384.0	14.2	11,822.0	3.9	12,686.0	7.3	14,289.0	12.6	14,721.0	-2.0
Liquor Tax	2,042.0	3.4	2,066.0	1.2	1,801.0	-12.8	1,914.0	6.3	2,000.0	4.5
Tobacco Excise Tax	1,012.0	2.6	1,011.0	-0.1	932.0	-7.8	957.0	2.7	987.0	3.1
Gasoline Tax	1,596.0	1.5	1,314.0	-17.7	1,365.0	3.9	1,423.0	4.2	1,503.0	5.6
Petroleum Tax	190.0	11.1	290.0	52.6	438.0	51.0	453.0	3.4	490.0	8.2
Consumption Tax	n.a.	n.a.	n.a.	n.a.	3,618.0	100.0	4,870.0	34.6	4,944.0	1.5
Commodity Tax	1,686.0	3.6	1,906.0	13.1	0.0	-100.0	0.0	0.0	0.0	0.0
Securities Transaction Tax	1,766.0	80.0	1,800.0	1.9	1,234.0	-31.4	1,020.0	-17.3	1,020.0	0.0
Motor Vehicle Tonnage Tax	486.0	-4.0	532.0	9.5	559.0	5.1	628.0	12.3	640.0	1.9
Customs Duty	599.0	25.3	703.0	17.4	759.0	8.0	864.0	13.8	850.0	-1.6
Other	201.0	-7.1	227.0	12.9	131.0	-42.3	134.0	2.3	139.0	3.0
Stamp Revenue	1,806.0	23.5	1,973.0	9.2	1,849.0	-6.3	2,026.0	9.6	2,148.0	6.0
Monopoly Profits	6.0	-21.1	8.0	33.3	7.7	-3.8	8.3	7.8	8.6	3.6
Public Enterprise Receipts	17.5	4.8	16.7	-4.6	16.9	1.7	17.6	4.1	19.0	8.0
Sale of Public Properties	180.6	34.3	126.1	-30.2	173.3	37.5	128.5	-25.9	127.2	25.8
Miscellaneous	1,586.7	-30.7	1,353.5	-14.7	2,385.4	-10.1	2,505.3	5.0	2,976.1	22.4
Public Bonds	10,539.0	-8.3	7,967.0	-24.4	7,111.0	-10.8	7,312.0	2.8	5,343.0	-4.4
Construction	6,880.0	20.7	6,196.0	-9.9	6,430.0	3.8	7,312.0	2.8	5,343.0	-4.4
Deficit-Financing	3,659.0	-36.9	1,771.0	-51.6	681.0	-61.5	0.0	-100.0	0.0	0.0
Carryover Surplus	2,339.4	430.1	2,974.6	27.2	2,390.6	-19.6	548.6	-76.5	101.9	-81.4

*Revised budget figures include the supplementary budget(s).
**Initial budget. Percent changes are based on the initial budget for FY 1990.

Source: Ministry of Finance

Table 4: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1987-FY 1991

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991	
Total Outlays	Y27,081.3	7.1%	Y29,614.0	9.4%	Y32,270.5	9.0%	Y34,572.4	7.1%	Y36,805.6	6.5%
Housing	6,328.2	8.1	6,921.5	9.4	7,460.6	7.8	8,365.9	12.1	9,474.5	13.3
Other Social Infrastructure	3,998.7	8.2	4,450.9	11.3	4,371.3	-1.8	4,222.0	-3.4	4,293.3	1.7
Welfare	627.7	0.3	661.8	5.4	736.0	11.2	851.9	15.7	1,026.1	20.4
Education	784.1	15.6	637.6	-18.7	520.2	-18.4	554.1	6.5	582.4	5.1
Small Business	3,985.6	7.7	4,030.6	1.1	4,176.4	3.6	4,337.8	3.9	4,494.5	3.6
Agriculture	907.8	0.6	979.4	7.9	924.4	-5.6	876.0	-5.2	908.2	3.7
Land Conservation and Disaster Work	493.0	16.6	409.8	-16.9	357.9	-12.7	328.5	-8.2	330.6	0.6
Roads	2,363.0	16.7	2,512.1	6.3	2,576.8	2.6	2,700.1	4.8	2,983.2	10.5
Transportation and Communications	2,264.1	12.4	2,229.9	-1.5	2,361.6	5.9	2,304.1	-2.4	1,468.1	-36.3
Regional Development	657.7	16.2	652.2	-0.8	676.6	3.7	682.5	0.9	709.0	3.9
Industry and Technology	630.9	-0.8	687.2	8.9	758.7	10.4	796.5	5.0	937.7	17.7
Foreign Trade and Economic Cooperation	690.5	-33.2	1,171.0	69.6	1,420.0	21.3	1,603.0	12.9	1,898.0	18.4
Cash Management	3,350.0	n.a.	4,270.0	27.5	5,930.0	38.9	6,950.0	17.2	7,700.0	10.8
Total Revenues	Y31,081.3	14.5%	Y33,114.0	6.5%	Y34,570.5	4.4%	Y36,572.4	5.8%	Y37,405.6	2.3%
Industrial Investment Special Account	144.3	134.6	91.2	-36.8	85.2	-6.6	64.1	-24.8	65.7	2.5
Trust Fund Bureau Fund	24,595.8	18.6	26,206.6	6.6	26,871.3	2.5	28,453.3	5.9	29,134.9	2.4
Postal Savings	7,900.0	12.9	7,900.0	0.0	8,500.0	7.6	7,200.0	-15.3	8,800.0	22.2
Pension Contributions	4,450.0	3.5	3,500.0	-21.3	4,310.0	23.1	5,540.0	28.5	6,430.0	16.1
Other Revenues	12,245.8	29.7	14,806.6	20.9	14,061.3	-5.0	15,713.3	11.7	13,904.9	-11.5
Postal Life Insurance Fund	3,941.2	25.3	4,409.4	11.9	5,614.0	27.3	6,055.0	7.9	6,305.0	4.1
Government-Guaranteed Bonds and Borrowings	2.400.0	-25.2	2,406.8	0.3	2,000.0	-16.9	2,000.0	0.0	1,900.0	-5.0

Source: Ministry of Finance

Table 5: Japan's Current General Account Budget Deficit, FY 1970-FY 1991

(in billions of yen and percent of total spending)

Fiscal Year	Initial Budget								Revised Budget	
	Construction Bonds		Deficit Bonds		Total Bonds		Debt Service		Total Bonds	
1970	Y430	5.4%	0	n.a.	Y430	5.4%	Y290.9	3.7%	Y347	4.2%
1971	430	4.6	0	n.a.	430	4.6	319.3	3.4	1,220	12.6
1972	1,950	17.0	0	n.a.	1,950	17.0	455.4	4.0	2,310	19.1
1973	2,340	16.4	0	n.a.	2,340	16.4	704.5	4.9	1,810	11.9
1974	2,160	12.6	0	n.a.	2,160	12.6	862.2	5.0	2,160	11.3
1975	2,000	9.4	0	n.a.	2,000	9.4	1,039.4	4.9	5,480	26.3
1976	3,525	16.0	Y3,750	19.3%	7,275	29.9	1,664.7	6.9	7,375	29.9
1977	4,430	11.9	4,050	17.8	8,480	29.7	2,348.7	8.2	9,985	34.0
1978	6,050	13.6	4,935	18.4	10,985	32.0	3,222.7	9.4	11,285	32.8
1979	7,215	12.5	8,055	27.1	15,270	39.6	4,078.4	10.6	14,050	35.4
1980	6,785	11.5	7,485	22.0	14,270	33.5	5,310.4	12.5	14,270	32.7
1981	6,785	11.8	5,485	14.4	12,270	26.2	6,654.2	14.2	12,900	27.6
1982	6,516	11.5	3,924	9.5	10,440	21.0	7,829.9	15.8	14,345	30.2
1983	6,365	9.9	6,980	16.6	13,345	26.5	8,192.5	16.3	13,486	26.1
1984	6,225	9.8	6,455	15.2	12,680	25.0	9,155.1	18.1	12,781	24.5
1985	5,950	9.4	5,730	12.8	11,680	22.2	10,224.1	19.5	12,308	22.8
1986	5,700	8.9	5,246	11.3	10,946	20.2	11,319.5	20.9	11,495	21.4
1987	5,520	10.2	4,981	9.2	10,501	19.4	11,333.5	20.9	10,539	18.1
1988	5,690	10.0	3,151	5.6	8,841	15.6	11,512.0	20.3	7,967	12.9
1989	5,780	9.6	1,331	2.2	7,111	11.8	11,664.9	19.3	7,111	10.7
1990	5,593	8.4	0	0.0	5,593	8.4	14,449.3	20.7	7,312.0	10.5
1991	5,348	7.6	0	0.0	5,348	7.6	15,834.3	22.5	n.a.	n.a.

Source: Bank of Japan and Ministry of Finance

Table 6: Japan's Cumulative General Account Budget Deficit, FY 1970-FY 1990

(in billions of yen and percent of nominal gross national product)

Fiscal Year	Construction Bonds		Deficit Bonds		Refinancing Bonds		Total Bonds	
1970	Y2,642.2	3.5%	Y168.8	0.2%	0.0	0.0	Y2,811.0	3.7%
1971	3,851.1	4.7	100.9	0.1	0.0	0.0	3,952.0	4.8
1972	5,818.5	6.0	0.0	0.0	0.0	0.0	5,818.5	6.0
1973	6,943.5	6.0	0.0	0.0	Y606.8	0.5%	7,550.3	6.5
1974	8,403.6	6.1	0.0	0.0	1,254.8	0.9	9,658.4	7.0
1975	11,178.4	7.3	2,116.9	1.4	1,677.7	1.1	14,973.0	9.8
1976	14,530.1	8.5	5,492.8	3.2	2,053.6	1.2	22,076.5	12.9
1977	19,280.8	10.1	10,253.5	5.4	2,367.9	1.2	31,902.2	16.8
1978	24,964.7	12.0	14,647.2	7.0	3,003.7	1.4	42,615.6	20.4
1979	32,181.7	14.3	21,065.7	9.3	3,003.7	1.3	56,251.1	25.0
1980	38,953.5	15.9	28,257.1	11.5	3,299.1	1.3	70,509.7	28.8
1981	45,149.7	17.4	32,916.3	12.7	4,207.3	1.6	82,273.3	31.7
1982	48,589.4	17.8	40,330.1	14.8	7,562.5	2.8	96,482.0	35.4
1983	51,366.3	18.1	47,059.9	16.6	11,268.4	4.0	109,694.6	38.6
1984	53,447.9	17.6	53,074.5	17.5	15,171.0	5.0	121,693.4	40.2
1985	52,830.3	16.4	57,306.0	17.8	24,295.0	7.6	134,431.3	41.8
1986	52,745.0	15.8	58,846.3	17.6	33,535.2	10.0	145,126.5	43.4
1987	51,923.4	14.8	56,803.0	16.2	43,082.8	12.3	151,809.2	43.2
1988	49,307.3	13.2	54,365.5	14.6	53,107.4	14.3	156,780.3	42.1
1989	48,732.6	12.0	47,825.5	11.8	64,351.8	15.8	160,910.0	39.6
1990*	47,076.6	10.7	40,614.6	9.3	74,534.8	17.1	162,226.0	37.2

*As of end of February, 1991. Percent of GNP based on projected FY 1990 nominal growth of 7.4 percent.

Sources: Bank of Japan and Ministry of Finance

Table 7: Revised FY 1991-FY 1995 Public Works Plan

(housing in thousands of units; all others in millions of yen)

	Original	Revised
Housing	6,700	7,300
Airports	Y1,920	Y3,190
Harbors	4,400	5,700
Water Supply	12,200	16,500
Sewage Treatment Facilities	1,910	2,830
Parks	3,110	5,000
Pedestrian Safety	1,485	2,015
Sidewalks	1,350	1,850
Other	135	165

Source: Ministry of Finance

NOTE

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JAPAN · ECONOMIC · INSTITUTE

JEI

REPORT

A Two-Part Report: A and B

NO. 19A May 17, 1991

THE FOREIGN TRADE ZONE FACTOR IN U.S.-JAPAN ECONOMIC RELATIONS

Summary

Foreign trade zones, areas within the United States that are considered outside U.S. customs territory, were authorized by Congress in 1934 to boost foreign commerce. The program got off to a slow start but recently has been expanding. Regulatory decisions made in the 1980s increased the incentives for manufacturing in foreign trade zones. This development led to enormous growth in FTZ use and also introduced an element of controversy. Allegations arose that the program harms some domestic industries by making it easier for zone manufacturers -- domestic or foreign-owned -- to incorporate foreign components into their products.

Among the benefits foreign trade zones extend to users are the opportunity to avoid, postpone or reduce tariffs on foreign goods. The program is especially attractive to producers in industries where tariffs on parts are higher than on the finished product, the automotive industry in particular. Car and truck assembly plants account for a significant share of zone activity; not coincidentally, American automotive parts manufacturers are among the most vociferous critics of the FTZ program.

Several years ago Congress took a close look at the operation of foreign trade zones and solicited views on the program from independent agencies, the private sector and the executive branch. The program's governing board now is working on the latest revisions of its guiding regulations. The redrafting process has highlighted the conflict between those who believe the program boosts overall American competitiveness by making manufacturing in this country more attractive and those who argue that

> foreign trade zones undermine the competitiveness of certain domestic industries. Although the debate has been somewhat subdued recently, increasing concern over the growing U.S. automotive parts deficit with Japan seems likely to refocus attention on foreign trade zones and their pivotal role in automotive manufacturing in the United States.

Origins of the Foreign Trade Zone Program

Congress passed the Foreign Trade Zone Act in 1934 to "expedite and encourage foreign commerce." Under the sponsor's list of aims were: "to encourage transshipment out of the country of goods that have been imported, to encourage the admixture of foreign goods with domestic goods and then shipping them outside the country."[1] Supporters of the act hoped the economy, which was in the throes of the Depression, could be reinvigorated by expanded trade, particularly transshipments (unloading foreign goods and reloading them to be sent to another country) and reexports. In their efforts to remove impediments to transshipments and reexports many lawmakers appeared wary of creating a program that would encourage greater imports. To address this concern the 1934 legislation explicitly excluded manufacturing and even exhibiting from FTZ activities.

The intent of the legislators who crafted the Foreign Trade Zone Act has been disputed ever since, particularly in the context of proposed changes to the current operation of the FTZ program. Most of the debate revolves around whether Congress intended FTZs to encourage imports. Critics who contend that the current program promotes imports argue that revisions made since 1934 caused the program to stray from the original legislative intent. The first major revision to the act was a 1950 amendment that allowed manufacturing and exhibiting in FTZs, a change meant to spur the establishment of zones and open up greater opportunities for American participation in international trade. Proponents framed the increase in imports expected to result from this amendment as a means of using American labor and materials to boost subsequent U.S. exports and of assisting European economies devastated by the war through purchases of their raw materials.

Accounts of the debate leading up to the 1950 amendment indicate that legislators and executive-branch representatives believed space and other constraints would limit manufacturing activity in foreign trade zones, which are located in or near U.S. Customs ports of entry. In 1952, however, regulations implementing the FTZ act were revised to allow for subzones -- special-purpose

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[1] U.S. Congress, House Committee on Ways and Means, Hearings on H.R. 3657, Foreign Trade Zones, 73rd Congress, 2nd Session, March 6 and 7, 1934, cited in U.S. Congress, House Committee on Government Operations, Foreign-Trade Zones [FTZ] Program Needs Restructuring (Washington, D.C.: November 6, 1989), p. 27.

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zones that are physically removed from their sponsoring general-purpose zone. While there is no legal difference in the kind of operation allowed in the two types of zones, general-purpose zones tend to incorporate several businesses that utilize the area for distribution or warehousing, while subzones encompass single-user manufacturing or assembling facilities.

Both types of foreign trade zones are considered outside the customs territory of the United States. This status allows firms bringing foreign goods into a zone to avoid customs entry procedures as well as the payment of duties and compliance with such restrictions as import quotas unless and until the goods enter U.S. customs territory. Zone status provides firms intending to sell their products in the domestic market with several advantages, such as delaying tariff payments and extending the opportunity to choose whether to pay duty on foreign materials when they are brought into the zone or when they enter U.S. customs territory. Duties on components generally are lower than on finished products, but in "inverted tariff" situations rates on finished items are lower than on some of the components. Completing products in a foreign trade zone, therefore, allows firms in industries subject to inverted tariffs to bring imported materials and components into the United States while taking advantage of the lower duties applicable to finished goods.

Recent Changes in the FTZ Program

Since establishment of the program the FTZ legislation has been amended and the implementing regulations have been revised, both with an eye to encouraging the use of FTZs and to resolving either zone users' problems or those of their competitors. Although the 1950 amendment to allow manufacturing in zones and the ensuing administrative authorization for subzones constituted a significant change in the program, these changes did not bring about an immediate surge in activity. The boom in manufacturing in subzones, considered the main source of increased zone activity, appears to have been spurred by more recent regulatory changes. A 1980 Department of the Treasury ruling removed from the dutiable value of a finished product the value added in the zone -- defined as a percentage of the value of processing and/or manufacturing costs as well as overhead and profit. The stated objective of this revision was to entice foreign automotive manufacturers to locate their operations in the United States. For some manufacturers paying duty on value added would have outweighed the benefits of utilizing a zone. A 1982 Customs Service decision further augmented duty savings opportunities for zone users by deleting brokerage and insurance fees plus transportation costs from the dutiable value of finished products. Reducing the dutiable value of goods processed in a zone to the value attributable to the foreign components in the finished product greatly boosted the appeal of subzone manufacturing.

More recent amendments made to the Foreign Trade Zone Act also have been aimed at increasing zone use in general and in specific sectors. For example, the act has been amended to exempt from state and local ad valorem taxation certain personal property located in an FTZ and to allow the use of domestic denatured spirits to make products in FTZs. Some legislation, however, has led to restrictions. The benefits of producing bicycles in zones were curtailed under legislation passed in direct response to concerns voiced by the domestic bicycle parts industry. None of the amendments enacted recently represents significant legislative change.

Expansion of FTZ Operations

By early 1991 more than 170 general-purpose zones and nearly 200 subzones had been authorized by the Foreign Trade Zones Board, which includes the secretaries of the Departments of Commerce and Treasury as well as the Secretary of the Army. (The input of each representative involved in the approval process roughly follows his or her agency's area of jurisdiction. The secretary of commerce serves as chairman of the FTZ board; Commerce also supplies the board with a small staff. The Army Corps of Engineers has the job of assessing the potential impact of FTZs on port and river facilities as well as on the environment.) Although not all the authorized zones are now in use, current figures far surpass the number of FTZs permitted prior to regulatory changes in the 1980s. In 1980, for example, there were only 54 general-purpose zones and nine subzones.

The value of merchandise going into foreign trade zones totaled $76.3 billion in 1989 -- the most recent data available (see Table). This reflected a 30 percent increase over the previous year and a striking contrast to 1980 when the value of materials moved into zones was $2.6 billion.

More than 2,000 firms used FTZs in 1989 for manufacturing, repackaging and dozens of other activities. Approximately 80 percent of these users are U.S.-based companies, recent estimates indicate. A list distributed by the FTZ board showing the main products produced in FTZs in 1989 included refined petroleum products, nonelectric machinery, electronics, orange juice concentrate and toiletries. Automotive assembly plants, however, constitute an overwhelming share of zone activity -- roughly 80 percent.

Although the number of general-purpose zones has increased steadily over the years, subzones nearly doubled in number between 1982 and 1983. With rapid growth since then the number of subzones surpassed general-purpose zones in 1990. Subzones have accounted for more than half the goods received in zones since 1979, and in the second half of the 1980s the figure was 90 percent-plus. In 1989, for example, subzones received $71.2 billion worth of goods, 93.3 percent of the total for all zones.

Data collected by the Foreign Trade Zones Board show that from 1985 to 1989 the share of domestic components in goods produced in subzones hovered around 80 percent. The foreign component in general-purpose zones far outweighed the domestic input, a reflection of the fact that these zones are used mainly for such activities as distribution and storage.

The FTZ Board points to a positive trend in the average ratio of exports to imports from a pre-1980 ratio of 0.3 to 1 to the 1989 level of 0.5 to 1. Yet critics of the FTZ program tend to highlight another ratio -- the percentage of zone shipments that enters the domestic market. While 33 percent of total shipments from general-purpose zones was exported in 1989, only 11 percent of shipments from subzones went to foreign markets. Zone shipments increasingly have been directed toward the American market since the mid-1970s, a trend that concerns those who believe FTZs displace domestic production.

Shifts in FTZ Use

A key factor behind the recent shift to subzones is the growing involvement of motor vehicle firms in the FTZ program. The first license for an automotive assembly subzone was granted in 1977; by 1986 the 24 active automotive

Foreign Trade Zone Statistics, 1989

(in billions of dollars unless otherwise indicated)

	1985	1986	1987	1988	1989
Merchandise Received					
General-Purpose Zones	$2.0	$2.6	$3.1	$4.3	$5.1
Subzones	22.8	37.6	45.8	54.4	71.2
Total	24.8	40.2	48.9	58.7	76.3
Foreign Receipts					
General-Purpose Zones	1.6	2.3	2.6	3.8	4.4
Subzones	4.1	6.9	7.9	10.3	14.4
Total	5.7	9.1	10.5	14.1	18.8
Domestic Inputs (%)					
General-Purpose Zones	19%	13%	17%	11%	13%
Subzones	82%	82%	83%	81%	80%
Average	77%	77%	79%	76%	75%
Outbound Shipments					
General-Purpose Zones	1.8	2.6	3.0	4.0	4.7
Subzones	32.7	47.5	52.6	68.1	80.5
Total	34.4	50.1	55.6	72.1	85.2
Exports					
General-Purpose Zones	0.6	0.7	0.9	1.1	1.5
Subzones	3.3	4.2	4.5	6.2	9.2
Total	3.9	4.9	5.4	7.2	10.7
Export Ratio (%)					
General-Purpose Zones	33%	26%	29%	26%	33%
Subzones	10%	9%	9%	9%	11%
Average	11%	10%	10%	10%	13%

Source: 51st Annual Report of the Foreign-Trade Zones Board to the Congress of the United States.

assembly subzones accounted for roughly 85 percent of the merchandise moving into all zones. Analysts point to several factors as being behind the steady growth of automotive assembly subzones since 1977. Increasingly stiff competition for sales in the American market between U.S. car and truck manufacturers and their foreign rivals forced the Big Three to make a number of adjustments; one of these included greater use of imported parts. Domestic automotive industry representatives note that the opportunity to use subzones to postpone and substantially decrease duties makes the incorporation of imported components into their finished products economically viable and helps them keep up with foreign automakers.[2]

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[2] U.S. General Accounting Office, Foreign Trade Zone Growth Primarily Benefits Users Who Import for Domestic Commerce, Report to the Chairman, Committee on Ways and Means, House of Representatives (Washington, D.C.: March 1984), p. 12.

Another way in which U.S. automotive manufacturers have sought to boost their competitiveness is through joint ventures with Japanese motor vehicle firms; this, too, has been a factor behind increased FTZ use. Moreover, while regulatory revisions in the FTZ program served as the carrot for Japan's automotive exporters to assemble their products in the United States, political-economic pressure provided a stick in various forms, such as the voluntary export restraint arrangement on cars reached with Japan in 1981 and domestic content bills for cars, passed in 1982 and 1983.

Transplant operations with zone status are subject to many of the same criticisms as other types of foreign direct investment in this country, but a 1989 congressional study also cautioned, "[T]he granting of subzones status to the traditional domestic firms may also pose a long-term threat to our nation's economic well-being."[3] While there has been little opposition to general-purpose zones over the years, the boom in manufacturing operations with subzone status has raised questions about the impact of subzones on American jobs, competitiveness and trade relations.

Impact of Subzones

In general, manufacturers confronted with inverted tariffs are responsible for most zone activity. While the opportunity to reduce tariffs on imported components is a key incentive for manufacturers to seek subzone status, this move also is one of the most controversial aspects of the FTZ program.

Inverted Tariffs and Imports - Trade experts note that FTZs give American producers some of the same advantages as offshore manufacturers, better enabling domestic products to compete with imported finished goods. Proponents stress that the program displaces imported final products, since, in their measure, a product manufactured in this country incorporating some foreign components outweighs an import made wholly of foreign materials. Yet some domestic industries counter that the program encourages imports.

Domestic producers of automotive parts, for example, see the inverted tariff situation as particularly damaging to their industry. Although tariffs on imported automotive parts average 4 percent but may be as high as 11 percent, the tariff on assembled cars is 2.5 percent. Not only do automotive assembly plants dominate subzone activity, most automotive assembly operations in the United States are conducted in subzones. The U.S. automotive parts industry contends that subzone operations, by permitting reduced tariffs on imported automotive parts, make American parts producers less able to compete. According to one representative of the parts industry, "[S]ubzones subsidize parts tariffs, transforming what Congress intended as a modest boost to local sourcing and turning that on its head by transforming it into an import incentive."[4]

The $8.3 billion-plus of foreign-sourced automotive parts flowing into subzones in 1989 represented 12 percent of all merchandise received in subzones that year and 58 percent of all foreign goods shipped into subzones. In 1986 the share of parts and materials imported into automotive subzones was 15 percent, down from 54 percent in 1979. Moreover, the Foreign Trade Zones Board reported that 18 percent of the $60 billion in parts used by automotive assembly plants in 1989 was of foreign origin. The drop in the percentage of automotive parts imported into subzones is said to stem in part from increased use of subzones by domestic automakers, which use fewer foreign components. The lower figure also reflects greater domestic sourcing of components by Japanese-affiliated U.S. motor vehicle plants, which also buy from Japanese parts suppliers that have set up operations in this country.

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[3] Committee on Government Operations, op. cit., p. 12.

[4] Statement of Lee Kadrich, Automotive Parts and Accessories Association, Inc. at hearing on Foreign Trade Zones held by Committee on Government Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, March 7, 1989.

U.S. automotive parts makers are not the only critics of the FTZ program. A 1989 General Accounting Office study concluded that, in effect, "[T]he United States has unilaterally reduced tariffs on auto parts, at least insofar as they are destined for use by auto manufacturers, without obtaining compensating tariff reductions from other countries, as may have been done if these tariff reductions had been effected through multilateral trade negotiations."[5] Moreover, the report stated, "[T]he marginal savings obtained through zone procedures neither provide domestic plants with a meaningful competitive advantage against imported cars nor provide significant incentive for locating production in this country." Both of these conclusions, however, have been countered by zone users. Although opponents of the FTZ program have questioned the impact of subzones on tariff revenues, the 1989 GAO report concluded that it would be difficult to ascertain the overall effect.

Employment Levels - Japanese companies assembling cars and trucks in the United States often are accused of relying too much on Japanese parts suppliers, whether located here or at home, and thus contributing to the demise of their American counterparts. Yet the job displacement effect of the transplants' sourcing is unclear. In fact, there is little agreement on the impact of any type of FTZ activity on overall U.S. employment. A 1984 GAO study concluded that at the local level the impact of FTZs on employment levels appeared to range from no change to gains. The study's attempts to gauge long-term employment effects at the national level resulting from the FTZ program were inconclusive.[6] A 1988 study by the International Trade Commission estimated that the FTZ program resulted in net employment losses ranging from zero to about 10,300, with the majority stemming from the automotive industry. The study cautioned, however, that these estimates may not reflect an accurate picture of changes in long-term U.S. employment levels. As an example of the varying effects of the FTZ program among different industries, the ITC report noted that while the automotive parts industry experienced significant job losses as a result of the growth in the program, employment opportunities in the automotive assembly industry itself grew.

The National Association of Foreign Trade Zones estimates that approximately two jobs are created or retained outside a FTZ's boundaries for each job within a zone. Thus, the estimated 137,000 FTZ positions correlate to more than

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[5] U.S. General Accounting Office, Foreign Trade Zones Program Needs Clarified Criteria, Report to the Chairman, Committee on Ways and Means, House of Representatives (Washington, D.C.: February 1989).

[6] GAO, 1984, op. cit., p. 27.

400,000 jobs in this country, the association says. Yet some industries stress that unless high value-added components are supplied by American manufacturers, the real benefits of zone manufacturing are exported.

Proposed Regulatory Changes

Many industry executives and analysts believe that changes in the use of FTZs necessitate adjustments in the way the program is run. The regulations implementing the Foreign Trade Zone Act of 1934 have not been revised formally since 1971, and most observers agree that the criteria used for approving FTZ applications need clarification. In particular, critics contend that the "public interest" provision is inadequate. Although the FTZ Board assesses the economic impact of granting a zone license, some critics argue that there is insufficient analysis of the potential effects on relevant domestic industries and on the national economy. These critics add that the lack of clear guidelines for approving proposed FTZs has led to a gap between the regulations and the practices of the board and, therefore, inconsistent consideration of applications.

In 1983 the board proposed regulations aimed at resolving these and other problems in the operation of the FTZ program, but these changes never were adopted. After further examination of the program in congressional hearings as well as in reports and studies by GAO and ITC, the FTZ Board again proposed regulatory changes in January 1990. These incorporated the 1983 suggestions as well as input from various reports and comments. The Department of Commerce noted that among the most significant revisions were "the listing of definitive criteria and procedures for manufacturing activity and subzones."

Last November the board amended its proposed regulations in response to numerous public comments; since then nearly 180 submissions have been received. Many of the comments were critical of the proposal to establish user fees to cover the costs of processing zone applications. A Commerce Department analyst said the board still is looking at ways to address the problems with this section. The new rules also would require zone applicants to provide the board with more information; subzone applicants would be required to submit evidence that significant public benefits would result from their manufacturing operations.

The National Association of Foreign Trade Zones contends that the proposed regulations are too restrictive and are overly burdensome for potential FTZ users. Yet representatives of the domestic automotive parts industry argue that the board's evaluation of a zone's impact on public interest should be even more deliberate, giving, for example, greater weight to such factors as potential harm to competing companies and evaluations of the negative impact on the U.S. trade imbalance. The FTZ Board is considering these and other disputed points of the proposed regulations. The board hopes to publish the final rules in July and put them into effect soon after, according to a Commerce Department analyst.

Congressional Outlook on FTZs

In contrast to active consideration of the FTZ program in several congressional committees a couple of years ago, Capitol Hill has been fairly quiet on this issue recently. There have been no major legislative initiatives addressing FTZs in the 102nd Congress, in part, congressional observers note, because a broad consensus is absent on Capitol Hill for changing the FTZ regulations one way or the other. No action was taken on a 1990 bill aimed at improving the FTZ program, and its sponsors reportedly have not decided whether to reintroduce the legislation this year. Some developing U.S. trade issues, however, may focus greater attention on FTZs.

U.S.-Japan Auto Parts Deficit - Lawmakers' recent criticism of the FTZ program has focused on the U.S. automotive parts industry. Rep. Marcy Kaptur (D, Ohio), a cosponsor of the 1990 FTZ bill, said the program "exacerbates the [auto parts] deficit by providing an incentive to import parts." She also characterized the program as inconsistent with U.S. trade policy initiatives, such as the 1986-87 MOSS (market-oriented, sector-selective) talks on automotive parts with Japan.

In 1990 the U.S. automotive parts deficit with Japan was calculated as $10.5 billion, making it a major factor in that year's overall bilateral trade imbalance of $41.1 billion. A just-released study by the University of Michigan predicts that the automotive parts deficit will reach $22 billion by 1994.[7] The Commerce Department's under secretary for international trade, Michael Farren, recently told a congressional panel that while this prediction may be surprising in light of the numerous Japanese automotive assembly plants established in this country, the figure assumes an increase in replacement parts. Critics have blamed the FTZ program for boosting the replacement market for imported parts simply because of increased access. The Michigan study also concludes that Japanese-owned automotive operations here will not significantly increase their purchases from traditional American parts suppliers; as a result, parts will account for an ever-greater share of the U.S.-Japan automotive trade deficit by 1994 -- 48 percent compared to 1990's 34 percent figure.

This specter of escalating automotive parts imports from Japan is particularly irritating to lawmakers frustrated over the U.S. parts industry's slight inroads into Japanese markets. Congress is expected to take a close look at the U.S. automotive industry in upcoming months, and it seems likely that the impact of FTZs on the domestic automotive parts industry will be considered in this context.

Maquiladoras - The key trade issue currently diverting most lawmakers is the Bush administration's proposed North American Free Trade Agreement. Among the many concerns over the proposed FTA is that it would increase the incentives for Japanese manufacturers to use Mexico as a base for processing goods for the American market.

Japanese firms currently have a relatively limited presence in maquiladoras, assembly plants located in Mexico that benefit from special U.S. and Mexican customs treatment as well as relaxed Mexican foreign investment regulations. Like FTZs, the maquiladora program has advantages for manufacturers since duties on products assembled in Mexico from American-made parts and shipped back to the United States are levied only on the value added in Mexico

[7] "Farren Sees 'Increased Attention' Eor Escalating Auto Parts Deficit With Japan," Inside U.S. Trade, May 3, 1991, pp. 4-5.

and foreign materials. FTZs on the U.S. side of the Mexican border play a role in the maquiladora system by, for example, storing or repackaging components destined for assembly in Mexico.

After the maquiladora program was set up in the 1960s some trade analysts expected Japanese firms to flock to Mexico to bypass U.S. import quotas and other restrictions on Japanese products. But involvement in the maquiladora program by Japanese business had a slow start. The handful of Japanese maquiladoras in the 1970s mostly concentrated on electronics products. Japanese firms' participation in the program accelerated with the expansion of U.S. car and truck assembly plants in the 1980s. Yet by late 1988 Japanese operations represented only about 3 percent of all maquiladoras in Mexico.

The majority of Japanese maquiladoras in operation in late 1988 had capital backing from Japanese affiliates in the United States. Like American companies, these affiliates benefited from transferring certain labor-intensive parts of their production processes to Mexico. Given Mexico's low wage scales and its proximity to the U.S. market, analysts expect the Japanese presence in the maquiladora system to expand. Although the impact of the proposed NAFTA on the maquiladoras is uncertain, some trade experts predict that the program will continue to be utilized by manufacturers that find it more cost-effective to base some part of their operations in Mexico.

The debate surrounding Japanese firms' participation in the maquiladora program echoes the pros and cons of their use of FTZs. Allegations that the program allows Japanese manufacturers to bypass U.S. trade restrictions and more readily increase imports into the American market are countered by arguments that Japanese maquiladora operations lead to jobs in this country that otherwise might have gone to other regions, particularly the Pacific Rim.

Outlook

Both the FTZ and the maquiladora programs were established in part to boost the international competitiveness of U.S. producers. There is little consensus in this country on whether the benefits that these programs also provide to Japanese manufacturers serve the long-term economic interests of the United States. While FTZs have not played a major role in U.S.-Japan trade relations, their connection to the contentious dispute over automotive parts imports puts the program under the microscope in light of the growing U.S.-Japan automotive parts deficit and bilateral trade tensions. Although changes in the operation of the FTZ program may ease some concerns, subzones in particular are unlikely to escape further attention as Congress takes an increasingly critical look at U.S. international competitiveness.

For further information, contact Margo Grimm.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

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Gulf Contribution Distorts Current Account Figures

On paper the figures looked impressive to those concerned about Japan's still large external imbalance. Japan's current account surplus fell another 15.8 percent in the first quarter of 1991 to $10.4 billion. Not since 1985 has the January-March figure been as low; furthermore, this was the ninth straight quarter in which the imbalance declined over the year-earlier period (see Table 1).

As the broadest measure of Japan's external imbalance, the current account statistics usually are considered more meaningful than the customs-clearance trade data; that indicator showed a somewhat larger imbalance in the first quarter than in the corresponding 1990 period (see JEI Report No. 16B, April 26, 1991). But, in this instance, the trade figures may present a truer

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1986	$92,827	$205,591	$112,764	$-4,932	$85,845	$-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1988	95,012	259,765	164,753	-11,263	79,631	-130,930
1989	76,917	269,570	192,653	-15,526	57,157	-89,246
1990	63,528	280,374	216,846	-22,292	35,761	-43,586
1989: I	21,311	66,945	45,634	-3,595	16,064	-5,612
II	19,794	66,560	46,766	-4,892	14,283	-30,801
III	19,770	68,157	48,387	-4,023	14,957	-21,559
IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990: I	14,393	65,460	51,067	-701	12,305	-16,086
II	13,614	65,510	51,896	-5,279	7,892	-18,985
III	17,149	70,500	53,351	-8,045	7,400	-7,247
IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991: I (p)	20,383	74,886	54,503	-468	10,360	10,612

picture. (For an explanation of both the trade and the current account data, see JEI Report No. 15A, April 19, 1991.)

In the first three months of 1991 the current account and the trade balance moved in opposite directions for one reason: most of Japan's $13 billion contribution to support the successful multilateral effort in the Persian Gulf War and to help hard-hit frontline states was disbursed during the quarter. This contribution pushed the unrequited transfers component of the current account into a $9 billion deficit in March alone, up from the usual monthly level of a few hundred million dollars and several times larger than any previous monthly deficit. In fact, the net transfers outflow in March was larger than any previous annual deficit in this component of the current account. Without this extraordinary item the current account surplus in the first quarter would have shown a 57.4 percent jump over the year-earlier period.

Tokyo's contribution to the Persian Gulf effort, while politically significant, was of limited importance economically. Unlike most other factors that push the current account down, it neither reflected increased Japanese demand for foreign goods and services nor reduced foreign demand for Japanese goods and services. Furthermore, it is unlikely to be a recurring expenditure. In short, the latest data suggest that, if anything, Japan's current account surplus is trending higher, not lower.

Current account surpluses imply offsetting outbound capital flows that finance the imbalance. As a result of the smaller surplus, capital outflows generally declined in the January-March period from the comparable 1990 period. In fact, as shown in Table 1, Japan experienced a rare net long-term capital inflow, in part because foreign investors betting on the continued recovery of the Japanese stock market poured $17.2 billion into net purchases of equities. In recent years Japanese long-term investors typically have channeled far more money abroad than their foreign counterparts have invested in Japan. The first quarter's reversal of net long-term flows, the first since 1982, came despite increased activity abroad by Japanese investors (see Table 2). Net bond purchases, the main portfolio investment for Japanese who invest overseas, exceeded the net of each of 1990's four quarters. Equity investors, however, continued their retreat from foreign stock markets; they registered a second straight quarter of net withdrawals. The strength of foreign equity markets during the January-March period, despite Japanese disinterest, suggests that Japanese money is not a necessary propellant in those markets.

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1986	$1,346,989	$1,253,965	$93,024	$20,917	$13,869	$7,048
1987	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1988	1,364,061	1,278,249	85,812	76,560	73,567	2,993
1989	1,683,733	1,589,650	94,083	97,056	79,169	17,887
1990	1,372,281	1,343,320	28,961	76,785	70,529	6,256
1989: I	341,774	327,771	14,003	17,724	17,828	-104
II	487,087	461,996	25,091	21,228	15,120	6,108
III	463,493	437,622	25,871	23,602	18,807	4,795
IV	391,379	362,261	29,118	34,502	27,414	7,088
1990: I	356,393	355,524	869	27,640	22,694	4,946
II	350,993	341,640	9,353	19,972	17,819	2,153
III	331,100	320,195	10,905	18,121	17,662	459
IV	333,795	325,961	7,834	11,052	12,354	-1,302
1991: I (p)	340,935	327,579	13,356	13,342	13,805	-463

The January-March period rounded out Japan's 1990 fiscal year. For the year the current account surplus came to $33.8 billion -- the fourth straight yearly decline and far below Tokyo's initial expectation of a $56 billion gap, although higher than last December's estimate of $32 billion (see JEI Report No. 11A, March 22, 1991). In its most recent economic outlook the government put the FY 1991 surplus at $30 billion. Tokyo's apparent optimism that the surplus will decline again in the current fiscal year finds little support among independent analysts, however. For example, Takuro Ban, director of the research department at Industrial Bank of Japan, Ltd., was quoted in early May as believing that the FY 1991 surplus will range between $45 and $50 billion. Nomura Research Institute puts the figure at $36.6 billion, Sumitomo Bank, Ltd. at $39.7 billion. In short, if this expert opinion is to be believed, the decline in Japan's current account surplus is over. Equally important, however, is that these analysts and organizations do not expect the imbalance to widen dramatically.

Private forecasts of the FY 1991 current account imbalance usually result from econometric exercises that include assumptions that Tokyo will reduce the discount rate and otherwise loosen monetary policy sometime during the April 1991-March 1992 period. If the Bank of Japan acts in accord with this thinking and thereby increases the relative attractiveness of overseas investment, the yen could be expected to weaken; in that case exports would be higher than otherwise and imports lower, increasing the current account surplus and the capital outflow. Washington has made no secret of its desire for lower Japanese interest rates (JEI Report No. 18B, May 10, 1991), although it does not seem reconciled to the larger Japanese current account surplus that probably would accompany such a move. Of course, the United States presumably would welcome the easing -- at least in the near term -- of the worldwide capital shortage, which would be yet another result of a more expansionary Japanese monetary policy. In short, Washington may have to decide whether it will be satisfied with lower Japanese interest rates or a declining Japanese external imbalance. It is unlikely to get both.

Douglas Ostrom

Some Financial Reforms On Track, Others On The Sidings

The Ministry of Finance continues to push its financial reform agenda on several fronts. MOF and other government agencies are drafting new versions of legislation that will alter the fundamental structure of Japanese financial markets. Even so, many observers are predicting that Japan's regulatory environment still will be more restrictive than that of either the United States or the European Community. Perceptions of such an "inequality" may leave Japanese financial institutions open to discriminatory treatment overseas.

Commercial and investment banking activities in Japan are separated by tough legal barriers (Article 65 of the Securities and Exchange Law), just as they are in the United States by the Glass-Steagall Act. Both Tokyo and Washington have been exploring ways to lower these barriers to promote competition and diversification by financial institutions while at the same time preventing abusive or risky business practices. MOF is juggling how to reconcile the differing viewpoints of the banking and securities sectors so that it can produce a new Securities and Exchange Law for submission to the next regular Diet session.

Two years of study by MOF advisory bodies have produced general agreement that the best vehicle for permitting head-to-head competition among all classes of Japanese financial institutions would be separately capitalized and operated subsidiaries. The major remaining differences between the Securities and Exchange Council (which includes representatives from brokerage houses) and the Financial Systems Research Council (which is tied more closely to the banking sector) concern the operations open to these new subsidiaries. Banks consistently have pushed for the maximum amount of freedom to compete in the underwriting and the brokering of stocks and bonds. Securities companies have tried to limit possible incursions into their business by banks, which generally are larger and have more staff as well as more extensive branch networks.

In a preliminary report released May 12 the Securities and Exchange Council called for direct competition between banks and brokerages only in the

Japanese financial institutions. Both Japan and the European Community are on record as opposing various aspects of the Department of Treasury's proposed overhaul of the U.S. financial system. The Financial Institutions Safety and Consumer Choice bill, introduced in March, would force foreign firms that want to engage in businesses other than that of the parent firm to establish separately capitalized and operated subsidiaries, a costly proposition. In addition, the Federal Reserve Board is seeking to expand its monitoring powers over foreign banks. The Foreign Bank Supervision Enhancement Act, which Sen. Donald Riegle (D, Mich.) put in the hopper May 9, would force foreign firms to obtain Fed approval for all activities, provide the Fed with the information necessary to perform its oversight duties, submit to examinations by U.S. regulatory authorities, and notify the Fed upon the purchase of 5 percent or more of an American bank's shares or the extension of any loan to a U.S. bank if the loan is secured by 25 percent or more of the bank's shares. Given a recent scandal involving a Washington-area bank and a Middle Eastern bank holding company, prospects for congressional approval of the new Fed powers are high.

Jon Choy

Japanese Business Leaders Prepare To Renew Ties To South Africa

Political and business leaders worldwide are watching expectantly for the end of apartheid laws in South Africa. Last February South African President F.W. de Klerk pledged to push for the repeal of laws constituting the framework of the apartheid system (see JEI Report No. 7B, February 22, 1991); the parliament in Pretoria is expected to abolish the laws before adjourning June 20. Some nations, including members of the European Community, have agreed to lift most economic sanctions against Pretoria if President de Klerk's promised reforms are approved. Japan has said that no decision on sanctions will be made until the discriminatory laws are repealed. The United States, however, has pointed to one additional roadblock to easing sanctions: release of all political prisoners and those held without trial.

While Tokyo waits to take official action, Japan's business community has begun to lay the groundwork for improved relations with South Africa. In late April Keidanren (Japan Federation of Economic Organizations) sent a 10-person mission to South Africa to assess social and economic conditions there. After meetings with President de Klerk and members of his government as well as antiapartheid leaders and representatives of the black business community, the mission concluded that while trade sanctions have had relatively little effect on South Africa, restrictions on investments and financial assistance have had a critical impact on both the economy and the social environment. The mission also contended that the Japanese government's sanctions were hindering the success of some Keidanren-funded educational and technical assistance projects aimed at helping black South Africans. A summary of the mission's report stressed that South Africa not only is an important source of materials for Japan, but that it serves as well as a center for regional progress.

In the Keidanren mission's view President de Klerk's recent initiatives address the principle objective of sanctions against Pretoria -- an end to apartheid. Noting that other countries have responded to Pretoria's pledges by taking steps toward lifting sanctions, the mission urged Tokyo to undertake a fundamental review of its policy toward South Africa. The leader of the mission, Bank of Tokyo vice president Tamotsu Yamaguchi, indicated that as a first step the government of Japan should state its position on lifting sanctions. Then Tokyo immediately should end its ban on sports and cultural exchanges, he said, but make this move contingent on apartheid laws being abolished in June. His views and the mission's recommendations have been taken under advisement by top Keidenren officials, who have not decided what course of action to recommend. Gaishi Hiraiwa, Keidanren's chairman, said, however, that Japan's current policy should be revised. He characterized Tokyo's response to the de Klerk government's initiatives as "delayed" in comparison to what other countries are doing. Keidenran reportedly plans to send a larger fact-finding mission to South Africa this fall.

Several political considerations argue for a delay in the lifting of Japan's economic sanctions. Tokyo is wary of making a move that could be considered profit-driven or insensitive to racial issues. Some Japanese government officials contend that Tokyo should not take any actions vis-a-vis South Africa that might jeopardize relations with other African nations, whose support is needed when the United Nations votes for nonpermanent seats on the U.N. Security Council this fall. Other government officials, however, see no problem if Japan ends its sanctions at the same time as other major industrialized countries. They argue that Japan should contribute to economic growth in South Africa and should encourage President de Klerk's efforts toward political reform.

While taking a cautious approach politically, Tokyo has arranged to extend various forms of aid to South Africa. In late March Tokyo promised $3.2 million to the U.N. High Commissioner for Refugees to aid political exiles resettling in South Africa. The funds are to come out of Japan's FY 1990 contribution to the U.N. organization. That same month Tokyo delivered on a pledge made last fall to provide a South African nongovernmental organization Y5.6 million ($41,500 at Y135=$1.00) for scientific equipment to be used by black schools in the Transvaal region. The grant was Japan's first direct assistance to a South African organization; previously aid was directed to South African NGOs through the United Nations and a Japan-European Community fund.

Tokyo is on record as saying that it would avoid direct involvement in the internal political affairs of any country. For that reason Prime Minister Toshiki Kaifu told African National Congress leader Nelson Mandela on his visit to Tokyo last fall that Japan would find it difficult to extend direct assistance to aid the ANC's efforts to provide housing, jobs and education for former political prisoners and exiles (see JEI Report No. 43B, November 9, 1990). Funneling aid through a third party was aimed at avoiding this restriction.

Japan's Trade with South Africa, 1985-90

(in millions of dollars)

	1985	1986	1987	1988	1989	1990
Exports	$1,019.9	$1,355.2	$1,863.3	$2,046.8	$1,717.3	$1,477.0
Imports	1,843.9	2,228.7	2,259.2	1,933.2	2,034.8	1,843.0

Source: Japan Tariff Association

As Keidanren's mission indicates, Japanese businesses are anticipating the end of economic sanctions and are starting to position themselves for a range of business opportunities in South Africa. The Ministry of International Trade and Industry is expected to relax soon its 1988 recommendation that Japanese businesses keep their trade with South Africa at or below the level of the previous year in dollar terms (see Table). Once sanctions are lifted, Japanese firms anticipate expanded possibilities to build or renovate factories, supply the South African market with cars and high-technology products, and import coal from that country.

Margo Grimm

Diet Adjourns

The 120th regular Diet session ended May 8 with final approval given to 14 treaties, 83 government-sponsored bills, 10 bills sponsored by Diet members and both the FY 1991 budget and a second FY 1990 supplementary budget. The latter measure included the nearly $9 billion financial contribution that Tokyo had pledged in January to help allied coalition forces in the Persian Gulf War; that amount followed earlier support of $2 billion for the allied forces and $2 billion to help frontline countries impacted by the war and the economic sanctions put on Iraq.

Helping the ruling Liberal Democratic Party to win passage of 83 of the 93 government-submitted bills were Komeito and the Democratic Socialist Party, the second- and the fourth-largest opposition parties. Although the behind-the-scenes maneuvering for support had generated much speculation by political analysts (see JEI Reports No. 7B, February 22, 1991, and No. 14B, April 12, 1991), the final votes showed significant support from the largest and the number-three opposition groups as well. The Socialist Democratic Party of Japan, the largest opposition group, opposed only three of the 83 measures. Even the Japan Communist Party seconded 57 percent of all the approved government-sponsored bills. Analysts view the high ratio of opposition support for the government-submitted bills as indicative of their realistic stance toward the lawmaking process. Moreover, aware of the opposition's majority in the upper house, LDP and government officials generally kept controversial bills from being introduced in the Diet until they had at least tacit backing from Komeito, the DSP and, if possible, the SDPJ.

Among the approved bills is a new child care leave law that allows either fathers or mothers working in firms with more than 30 employees to take unpaid leave for one year to care for their infant. A land policy package also received approval; it included restrictions on financing of land purchases by nonbanking financial institutions, an amendment of the productive green space law and a new landholding tax (see JEI Reports No. 5B, February 8, 1991, and No. 15B, April 19, 1991). Proposed changes to the Land Lease and the House Lease Laws will continue to be debated in the next Diet session.

Implementation of Tokyo's pledges made during last year's Structural Impediments Initiative discussions with Washington (see JEI Report No. 26B, July 6, 1990) included some changes in the Antimonopoly Law. The Large Retail Store Law also was revised to speed the regulatory process at the national level for opening department stores, supermarkets and other big outlets, which are more likely to carry foreign products. Large retailers, for example, no longer will need the approval of neighboring shopkeepers before opening a store.

One environment-related bill winning passage corresponded to Japan's support for the Montreal Protocol, which aims to eliminate the production of chlorofluorocarbons by the year 2000; the bill restricts use of CFCs. Also approved was a bill that promotes recycling. Legislation attempting to achieve quantitative reductions in the amount of garbage disposed failed to win passage.

Technical amendments to the 3 percent consumption tax were approved following an accord between the LDP and the opposition parties in the final stage of the Diet session. These changes will go into effect October 1. The list of goods and services exempted from taxation was extended to include rents, educational fees and charges for births or burials. In other changes store operators that collect more than Y5 million ($37,000 at Y135=$1.00) a year in consumption tax proceeds will have to forward the money to the government quarterly instead of semiannually. The tax treatment of different types of businesses for consumption tax purposes also was altered.

A bill that would have increased copayments for medical care for those over age 70 or those aged 65 and bedridden will be resubmitted to the next Diet session. Other measures considered possible candidates for future Diet action are a package of political reforms and a bill enabling Japanese personnel to join United Nations-sponsored peacekeeping operations. Although Prime Minister Toshiki Kaifu had intended to push these controversial measures, the government ended up not introducing the bills. An earlier version of the peacekeeping bill was pulled from consideration last year after much public opposition (see JEI Report No. 44B, November 16, 1991).

Tadashi Saito

Tokyo, Washington Take Differing Paths In Transportation/Environment Debate

The recent release of the Environment Agency's annual report, which focused in part on how to limit motor vehicle emissions, and current debates in Congress on related issues highlight the different approaches of Japan and the United States to environmental regulation. Reduction of gases thought to contribute to global warming forms one of the main themes in the Environment Agency's report. (The other addresses the effect of war on the environment.) Legislation being considered on Capitol Hill has much more diversified goals, making comparisons difficult. Even so, bills addressing transportation and energy policies give an indication of what the United States will be doing differently from Japan on environmental issues related to global warming.

A proposal to restrict tailpipe emissions from diesel-fueled vehicles is part of a one-two punch sure to be fought by Japan's trucking industry. At a press conference prior to the white paper's distribution, the director of the Environment Agency's planning and research division said that vehicles powered by diesel have fewer restrictions on emissions than do gasoline-fueled vehicles and, thus, are a logical target for increased attention. Specifically, the agency has proposed standards for diesel-powered vehicles that are 24 percent below current levels of nitrogen oxide emissions, one of the so-called greenhouse gases. Since carbon dioxide also is a byproduct of diesel-powered vehicles and judged by some scientists to be one of the largest contributors to global warming, the agency anticipates that fewer NO_x emissions will be mirrored by lower CO_2 levels. However, the planning division's Toshiro Kojima also told reporters that the cuts in emissions may be difficult to achieve because so many diesel trucks are used by small and medium-sized firms, which might not be able to afford trucks that meet the new standards.

The number of diesel-fueled vehicles in Japan is on the rise, which is why the Environment Agency has drawn attention to this type of vehicle (see Table 1). Part of the popularity of diesel vehicles is the price of fuel; at about Y70 a liter ($2.65 a gallon at Y135=$1.00) diesel is significantly cheaper than gasoline, which runs about Y120 a liter or $3.36 a gallon.

Table 1: Diesel Vehicles in Use, 1985-89

(in millions of vehicles and percentage within each category)

	1985		1986		1987		1988		1989	
Cars	1.25	4.5%	1.48	5.2%	1.73	5.9%	2.02	6.6%	2.41	7.4%
Trucks	4.00	23.4	4.27	23.6	4.60	24.0	5.03	24.7	5.45	25.8
Buses	0.21	90.4	0.21	92.1	0.22	93.6	0.23	94.8	0.23	95.8
Other	0.77	81.4	0.80	82.2	0.85	82.7	0.91	83.6	0.97	84.3
Total	6.23	13.5	6.78	14.1	7.40	14.8	8.19	15.6	9.06	16.4

Source: Ministry of Transportation

One carrot suggested for encouraging the move to less-polluting diesel trucks is the use of tax incentives; another idea is increased use by municipal governments of electric-powered buses and garbage trucks. Another innovative suggestion in the white paper is that one of the icons of Japan's industrial efficiency -- just-in-time delivery -- be reviewed since the system requires what one news report called an "excessive use of delivery trucks."

The second part of the punch to the Japanese trucking industry accompanied the white paper's call for more long-distance domestic cargo to be carried by trains and ships. The powerful trucking industry has long hauled about 90 percent of all in-country cargo, with water-borne transportation accounting for about 8 percent and railroads the rest. The Environment Agency's white paper notes that trains release only about 1/15 the amount of carbon dioxide that diesel trucks do for the same amount of cargo transported; ships produce about 1/10 diesel vehicles' CO_2 emissions. However, given the long-term implementation period expected for the Ministry of Transportation's trucking industry deregulation guidelines and regulations (see JEI Report No. 17A, April 27, 1990), the prospects seem dim for the Environment Agency's proposal to make quick headway.

Equally contentious transportation-related proposals are being considered on Capitol Hill. Two recently introduced measures attempt to define a broad-based U.S. transportation policy. The contrast between the two measures was described by a new daily environmental news service, Greenwire, as "the sleeper environmental issue of the year." One of the main differences between the bill backed by the Bush administration and legislation introduced by Sen. Daniel Patrick Moynihan (D, N.Y.) is that the New York senator's measure would allocate highway trust funds based on population rather than fuel consumption patterns, which is the base for the administration's bill. The Moynihan measure also would set aside funds to help boost compliance with air quality standards in cities that fall short of the standards, often because of traffic haze. The White House version, introduced by Sen. John Chafee (R, R.I.), encourages more highways and expanded traffic lanes. Both bills advocate more use of mass transit, but the administration-supported measure leans toward more interstate commerce via highways.

Although neither measure addresses global warming problems in the same way that the Environment Agency's white paper does, the role of the transportation sector in contributing to emissions of carbon dioxide is possibly more significant in the United States than in Japan. A 1991 report by the Office of Technology Assessment rated transportation responsible for 32 percent of America's 1987 CO_2 emissions. In comparison, the Environment Agency report indicated that transportation accounted for 19.4 percent of Japan's CO_2 emissions in 1989, up from 13.1 percent in 1973. Industry contributed 49.5 percent (32 percent in OTA's study of U.S. emissions), with electric utilities at about 8 percent and the household sector at 23.2 percent. (OTA rated U.S. building emissions at 36 percent.)

While CO_2 emissions are not the main focus of the two U.S. transportation policy proposals, measures addressing America's energy policy tackle the subject more directly, including bills calling for higher CAFE (corporate average fuel economy) standards. One controversial proposal by Sen. Richard Bryan (D, Nev.) calls for boosting CAFE standards to as much as 45 miles per gallon by 2001 to help America cut its oil consumption and to help reduce CO_2 emissions. What makes Sen. Bryan's bill a magnet for criticism is its effort to force car companies that already have surpassed the 27.5 mpg standard to increase their 1988 fleet average by a flat 20 percent by 1996 and 40 percent by 2001. Ironically, the bill would allow Suzuki Motor Co., Ltd. to reduce its 1988 CAFE level of 50.3 mpg (see Table 2). This is one reason critics argue that the Bryan bill has the potential to discourage companies that already have achieved high fuel efficiency from new innovations.

Another criticism posed in a Washington Post editorial is whether the bill is an indirect attempt at protectionist legislation, since Japanese automotive makers would be particularly hard-pressed to achieve greater fleetwide efficiency without trimming the number of midsized and luxury cars they sell in the United States. Since domestic car manufacturers oppose higher CAFE standards as much as Japanese companies do, many in Congress are awaiting a report on fuel efficiency from the National Academy of Sciences, due out in late June. Reports from Capitol Hill suggest, however, that reservations by the motor vehicle industry may be weighed against the significant gains made after Congress mandated CAFE levels in the 1970s; at the time the automotive industry said the technology did not exist to achieve a standard of even 27.5 mpg.

The Bush administration has said that it wants to take a diversified approach to offsetting the potential hazards of global warming, working through transportation policy, energy policy and a variety of other interests but not focusing solely on meeting a set target of greenhouse gas emissions. In the process, though, its attention to global warming appears to suffer. More direct

Table 2: Corporate Average Fuel Economy Compliance and Proposed Changes*

Japanese Badged-Cars	1988	2001*
Suzuki Motor Co., Ltd.	50.3 mpg	45.0 mpg
Daihatsu Motor Co., Ltd.	46.8	45.0
Isuzu Motors Ltd.	34.9	45.0
Toyota Motor Corp.	33.0	45.0
Honda Motor Co., Ltd.	32.1	44.9
Fuji Heavy Industries, Ltd. (Subaru)	31.9	44.7
Mitsubishi Motors Corp.	31.2	43.7
Nissan Motor Co., Ltd.	30.8	43.1
Mazda Motor Corp.	28.7	40.2
American Badged-Cars		
Chrysler Corp.	28.5	39.9
General Motors Corp.	27.6	38.6
Ford Motor Co.	26.6	37.2

*Sen. Richard Bryan's amendment to the Motor Vehicle Information and Cost Savings Act (S 279) seeks a 40 percent increase over the 1988 CAFE levels achieved by each car maker, up to a 45 miles per gallon cap. The current standard is 27.5 mpg.

Source: Department of Transportation, Summary of Fuel Economy Performance, February 1, 1991.

in its stated goals, Tokyo has said that it will stabilize carbon dioxide emissions at 1990 per capita levels (which allows for a slight increase based on population increases) and has set restrictions on the use of chlorofluorocarbons. But Japan also is taking a diversified approach, with the Environment Agency making recommendations that cross other ministries' jurisdictions and that hint at fundamental changes in traditional patterns of transportation and distribution. At the very least the agency's white paper suggests a willingness to shake up the status quo, even if the path to success is as rocky as that facing the U.S. legislative process.

Pat Murdo

Notes

SII - Subcabinet-level trade officials from the United States and Japan will meet in Tokyo May 20-21 to review the progress each country has made in dismantling the structural barriers to trade identified in the final report on the Structural Impediments Initiative (see JEI Report No. 26B, July 6, 1990) and to summarize the results of the review process in a jointly issued report. The sections dealing with Japan's efforts to bridge its savings-investment gap and reform the country's distribution system will be relatively easy to draft since Washington already has credited Tokyo with significant progress in boosting public works expenditures and speeding up and streamlining the regulatory

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JAPAN'S ECONOMIC RELATIONS WITH AUSTRALIA: MEETING THE CHALLENGES OF INTERDEPENDENCE

Summary

Australia's long-running surplus in trade with Japan stands in marked contrast to the experience of the United States, yet similar problems have soured both countries' economic relations with Japan. Drawing on its vast natural resources, Australia supplies bulk commodities to Japan, which ships back capital and consumer goods and channels money into mining projects and real estate purchases, especially tourist-related facilities. Despite the surplus, Canberra complains that Japanese companies seem uninterested in buying Australian manufactured goods other than low value-added products. Moreover, Canberra contends, Japan's business community appears reluctant to transfer technologies that could strengthen Australia's competitiveness in high value-added goods.

The influx of Japanese tourists to Australia and related investment capital comes at a time when Australians are reexamining their historic economic and political ties to Europe. Good relations with their Asian neighbors, especially with economic superpower Japan, are important for Australia's perception of its economic and political roles in the changing world order. At the same time few Japanese seem to realize the great impact of their economy on Australia, which, in some cases, has created tensions in Australian society. Coming to grips with the economic interdependence of Japan and Australia and the problems generated by this type of relationship represents one of the major challenges facing Tokyo and Canberra.

Structure of Japan-Australia Trade

Japan generally has viewed trade relations with Australia as being driven by its own imports rather than its exports. Until relatively recently Japanese trade policy gave a high priority to finding stable supplies of agricultural and industrial inputs as well as to promoting the sale of manufactured products overseas. Australia, with its rich natural resources and its geographical proximity to Japan, was an ideal supplier of wool, iron ore, coking coal and a long list of other bulk commodities or semiprocessed materials. Last year Australia supplied 62.5 percent of Japan's wool imports, 43 percent of its iron ore requirements and 45.5 percent of the foreign coking coal bought by Japanese steel mills. After the twin oil crises of the 1970s Japanese industry worked to diversify its energy mix and its supply sources to be less dependent on Middle Eastern oil. Australian steam coal, which provided 69.1 percent of Japan's 1990 imports of that fuel supply, was a major alternative source for electric utilities and big industrial users.

Australia also had the largest share of Japan's imported beef market in 1990 -- 52.1 percent. Moreover, it supplied 38.8 percent of raw sugar cane imports and 18.5 percent of purchases of nonferrous ores. In value terms over three-fourths of Japan's imports from Australia last year consisted of agricultural and industrial inputs; adding in purchases of such industrial supplies as nonferrous metals boosted the figure for natural resource-based imports to around 90 percent (see Table 1). Even though manufactured products made up 50.3 percent of Japan's 1990 imports, the composition of its purchases from Australia put that country in a virtual tie for the number-two supplier spot with Indonesia, Japan's third-largest source of crude oil and the top seller of liquefied natural gas (see Table 2).

Almost mirroring the dominant role of primary commodities in Japan's imports from Australia is the concentration of Japan's Australia-bound shipments on machinery and transportation equipment, particularly cars and trucks. But Australia always has been far less important as a market for Japanese exporters than as a supplier to these same manufacturers, ranking ninth on the list of Japan's biggest customers in both 1989 and 1990. That fact has kept the country's trade with Australia in the red for the last 31 years (see Table 3).

From the Australian viewpoint Japan is its largest customer as well as its second-largest supplier. From July 1988 to June 1989 -- Australia's FY 1988/89 -- sales to Japan represented 27.3 percent of Australia's exports; this was nearly three times the figure for the United States. Its foreign suppliers are almost balanced, however; the European Community accounted for 22.9 percent of Australia's imports in FY 1988/89, the United States 21.5 percent and Japan 20.7 percent (see Table 4). But unlike the surplus Australia runs in trade with Japan, imports from both the United States and the EC far exceed exports to those trading partners.

Impact of Exchange Rate Changes On Australia's Trade

Its expanding surplus with Japan notwithstanding, Australia's overall trade (exports f.o.b., imports c.i.f.) was in deficit throughout the first half

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Table 1: Commodity Composition of Japan's Trade with Australia, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share
Food	$34.8	0.5%
Textiles and Apparel	158.8	2.3
Synthetic Fabrics	47.6	0.7
Chemicals	305.2	4.4
Plastic Materials	85.8	1.2
Nonmetallic Mineral Products	88.1	1.3
Metals and Fabricated Metal Products	356.9	5.2
Steel	221.6	3.2
Nonferrous Metals	22.5	0.3
Fabricated Metal Products	112.7	1.6
Machinery and Transport Equipment	5,338.2	77.4
Nonelectric Power Generating Machinery	175.1	2.5
Computers and Other Office Machines	485.8	7.0
Metalworking Machinery	57.2	0.8
Bearings	39.7	0.6
Electric Power Generating Machinery	49.4	0.7
Televisions	26.0	0.4
Radios	48.3	0.7
Electronic Tubes and Semiconductors	53.6	0.8
Motor Vehicles	2,062.9	29.9
Motorcycles	49.6	0.7
Ships and Boats	168.7	2.4
Scientific and Medical Equipment	245.4	3.6
Videocassette Recorders and Players	169.9	2.5
Other	618.4	9.0
Tires and Tubes	152.1	2.2
Total Exports	6,900.3	100.0

Imports	Amount	Share
Food	$1,972.5	15.9%
Meat and Meat Products	899.5	7.3
Fish and Fish Products	261.5	2.1
Wheat	182.3	1.5
Sugar	204.9	1.7
Textile Fibers	857.0	6.9
Wool	693.5	5.6
Cotton	162.7	1.3
Metal Ores and Scrap	2,234.3	18.1
Iron Ore	1,315.3	10.6
Steel Scrap	23.9	0.2
Nonferrous Ores	801.9	6.5
Other Raw Materials	434.5	3.5
Hides and Skins	110.7	0.9
Crude Nonmetallic Minerals	214.2	1.7
Mineral Fuels	3,948.7	31.9
Coal	3,004.2	24.3
Crude Oil	255.0	2.1
Chemicals	121.5	1.0
Machinery and Transport Equipment	176.9	1.4
Computers and Other Office Machines	22.1	0.2
Nonelectric Power Generating Machinery	27.2	0.2
Other	2,623.6	21.2
Steel	62.3	0.5
Nonferrous Metals	1,072.9	8.7
Total Imports	12,368.8	100.0

Source: Japan Tariff Association

Table 2: Japan's Major Trading Partners, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share	Imports	Amount	Share
United States	$90,322.4	31.5%	United States	$52,368.6	22.3%
West Germany	17,782.0	6.2	Indonesia	12,721.3	5.4
South Korea	17,457.2	6.1	Australia	12,368.8	5.3
Taiwan	15,429.8	5.4	China	12,053.5	5.1
Hong Kong	13,071.9	4.6	South Korea	11,706.7	5.0
United Kingdom	10,786.1	3.8	West Germany	11,487.1	4.9
Singapore	10,707.8	3.7	Saudi Arabia	10,461.6	4.5
Thailand	9,126.0	3.2	Arab Emirates	9,084.6	3.9
Australia	6,900.3	2.4	Taiwan	8,496.4	3.6
Canada	6,726.5	2.3	Canada	8,392.2	3.6
Total Exports	286,947.5	100.0	Total Imports	234,798.6	100.0

Source: Japan Tariff Association

Table 3: Japan's Trade with Australia, 1960-90

(in millions of dollars; exports f.o.b., imports c.i.f.)

Year	Exports	Imports	Balance
1960	$144	$344	$-200
1965	313	552	-239
1970	589	1,508	-919
1975	1,739	4,156	-2,417
1980	3,388	6,982	-3,593
1985	5,379	7,452	-2,073
1986	5,227	6,980	-1,753
1987	5,146	7,869	-2,723
1988	6,680	10,285	-3,604
1989	7,805	11,605	-3,800
1990	6,900	12,369	-5,469

Source: Japan Tariff Association

of the 1980s. The international currency realignments set in motion by the September 1985 Plaza Accord only compounded Australia's problems. The Australian dollar depreciated against the yen, falling from Y165 in June 1985 to Y105 as of June 1988; it also fell against major European currencies. It increased, however, vis-a-vis the U.S. dollar, rising from 66.4 cents to 80.9 cents over the same time frame. Since the bulk commodities that make up most of Australia's exports are priced in U.S. dollars on the international market, the Australian dollar's higher value undercut Canberra's efforts to boost foreign sales. Moreover, the Australian dollar's depreciation against the yen and European currencies upped the cost of imports from Japan and the EC. To make matters worse, the growth of world trade in primary commodities in the second

Table 4: Australia's Major Trading Partners, FY 1988/89*

(in millions of Australian dollars**)

Exports	Amount	Share	Imports	Amount	Share
Japan	A$11,840	27.3%	United States	A$10,129	21.5%
United States	4,422	10.2	Japan	9,766	20.7
New Zealand	2,210	5.1	Great Britain	3,454	7.3
South Korea	2,174	5.0	West Germany	2,951	6.3
Hong Kong	1,888	4.3	New Zealand	1,970	4.2
Taiwan	1,566	3.6	Taiwan	1,920	4.1
Great Britain	1,521	3.5	Italy	1,382	2.9
European Community	6,002	13.8	European Community	10,775	22.9
Total Exports	43,409	100.0	Total Imports	47,073	100.0

*From July 1988 to June 1989.
**A$1.00=U.S.$0.755 as of June 1989.

Source: Australian Bureau of Statistics

half of the 1980s generally lagged that of manufactured products. By yearend 1989 Australia's trade deficit, which had totaled $455 million in 1980 and just under $3.2 billion in 1985, had swelled to $7.3 billion.

With the trade deficit soaring and inflation again on the rise, Canberra undertook a review of its industrial and trade policies with the aim of promoting production and exports of manufactured goods. The government began to dismantle protectionist measures for domestic manufacturers as a way of fostering an export-oriented manufacturing sector capable of meeting international competition head-to-head. Although academics may regard Japan-Australia trade as a good example of the international division of labor, Canberra saw the country's dependence on exports of primary commodities as implying a long-term deterioration in its terms of trade.

The yen's appreciation between 1985 and the end of 1988 coincided with a period of expanding domestic demand in Japan. These parallel developments hiked imports of manufactured products. But even though overall Japanese purchases of foreign manufactures jumped from $40.2 billion in 1985 to $118 billion last year, Australia's exports of metals, chemicals, capital and consumer goods, and similar products to Japan remained basically unchanged. That situation has led to Australian claims that Tokyo ignores Canberra's requests for improved market opportunities in Japan for domestic suppliers of manufactured products while acceding to the market access demands of the United States and Europe, with which Japan runs large trade surpluses. Adding to the bilateral friction is the high public visibility of Japanese-made manufactured products, especially consumer goods, in Australia. Although the country sells more to Japan than it buys, this profile has led to charges that Japanese producers have targeted Australian markets.

Problems in the Manufacturing Sector

Japanese manufacturers dismiss these charges as off-target. The relatively strong showing of made-in-Japan products in Australia, they say, stems more from the country's underdeveloped industrial sector than a market drive by Japanese competitors. With a population of only 17 million spread over an area equal to about 82 percent of the U.S. land mass, Australia is a small market, and that hinders achievement of the economies of scale necessary for efficient production of consumer or capital goods. Moreover, limited economic infrastructure, particularly in the transportation area, restricts domestic industry's development. The ability of agriculture and mining to foster the economy's expansion over the years and provide a fairly high standard of living for Australians also is cited as a reason the country has not pushed harder to develop its manufacturing industries.

Even though the government has campaigned for Australians to buy domestic, sales of foreign-made goods remain high. As noted, Canberra until recently promoted domestic manufacturers by supporting an import-substitution policy that involved high tariffs on manufactured imports, local content requirements for foreign investors and subsidies for local suppliers. The government realized in the late 1980s, however, that this policy had backfired. Inefficiencies were rife, potential foreign investors often were deterred by the local content rules, and the country's dependence on foreign sources of supply had increased. The decision to dismantle protectionist measures was designed in part to attract foreign investors that could help Australian manufacturers improve their competitiveness.

Investment and Technical Assistance

Government officials in both Australia and Japan understand that it is very difficult to change the traditional structure of bilateral trade in the short run. Thus, Canberra has sought Tokyo's help in facilitating the transfer of Japanese manufacturing product and process technologies and in encouraging the private sector to invest in Australia.

During the 1970s Japanese direct investment in Australia largely went into mining, particularly coal, as companies scrambled to gain access to low-cost sources of industrial supplies. Some money also went into the nonferrous metals industry, again to tap lower-cost supplies, and into the motor vehicle industry to avoid the high tariffs on cars and trucks. Japanese investment in Australia stagnated in the early 1980s, reflecting the economic slowdown in both countries. The appreciation of the yen and Canberra's decision to liberalize the investment environment for foreign businesses, however, have revived Japanese investors' interest in Australia. In the April 1989-March 1990 period, the latest fiscal year for which data are available, Japanese companies plowed $4.3 billion into Australian direct investments, nine times more than in the April 1985-March 1986 time frame. In fact, Japan has been the largest foreign direct investor in Australia on an annual basis since that country's FY 1987/88, although cumulatively its ranking remains third, after Great Britain and the United States.

Now, however, well over half of the $12.4 billion Japanese companies have invested in Australia is in real estate, services, particularly those related to tourism, and banking and finance. Not surprisingly, Canberra would be happier if more money went into the manufacturing sector, which accounted for just 15 percent or so of cumulative Japanese investment as of March 1990. According to 1989 Australian statistics, over 80 percent of Japanese investment that year was channeled into the service sector, while 11 percent was earmarked for manufacturing and 6 percent for mining. In the same period 27 percent of American investment in Australia was directed to manufacturing and 17 percent to mining. Companies headquartered in the European Community put 29 percent of the money they invested in Australia into manufacturing and 14 percent into mining.

After complaints by Canberra about the short shrift Japanese investors were giving the manufacturing sector, the Ministry of International Trade and Industry in 1987 came up with the awkwardly named multifunction polis concept. The idea is analogous to MITI's technopolis plan, which is designed to stimulate local economies around the country by facilitating in each prefecture the establishment of specific high technology industries and associated academic research facilities. Then Prime Minister Noboru Takeshita and his Australian counterpart, Robert Hawke, endorsed the multifunction polis idea at a 1988 summit meeting.

Last year the Australian government decided to construct as a national project a multifunction polis in Adelaide, the capital of South Australia. The blueprint lays out a high technology research-related industrial city with a prospective population of 100,000. The cost of the project by the year 2010 is estimated at A$17.7 billion (U.S.$13.8 billion at A$0.78=US$1.00). The Australian federal and state governments will cover 20 percent of the construction costs, primarily those linked to infrastructure; the rest is to be financed by the private sectors in both Australia and Japan and, possibly, third countries. The multifunction polis is expected to be a model high technology research center that helps to upgrade the competitiveness of Australia's manufacturing sector as a whole.

Although the ruling Labor Party is portraying the project as a symbol of cooperation with Japan, the opposition parties, a coalition of the Liberal Party and the National Party, are skeptical of the concept and cautious about Japanese involvement in domestic industrial policy formulation. Some environmental activists also have expressed concern about the destruction of a mangrove forest at and surrounding the construction site.

The plan for the multifunction polis and concern about the increase in Japanese investment became key issues in the 1990 general elections. Although the Hawke government narrowly squeaked out a victory, just exceeding a majority in the lower house, the fact that almost half of the electorate supported the opposition was interpreted to mean that many Australians are uneasy with the development idea advanced by MITI as well as both the level and the type of Japanese direct investment in their country.

With the Australian public appearing cool to the multifunction polis project, Japanese businesses have been slow to get involved. Although almost 80 Japanese companies are listed as belonging to a group formed to study the plan, less than 30 are manufacturers, including only nine involved in the high technology areas of electronics and telecommunications equipment. The majority of the businesses interested in the plan are contractors, trading houses, banks and other service companies -- in other words, firms outside the research and development field. From the viewpoint of Japanese manufacturers, Australia is not as attractive as a production or research site as Singapore, Malaysia and other Asean (Association of Southeast Asian Nations) members. Improvement of Australia's nationwide transportation system and more government involvement in the settlement of industrial disputes no doubt would instill greater confidence in Japanese investors. Also mentioned by Japan's business community as a prerequisite for more investment is further liberalization of Canberra's investment regulations. Without these moves, the Adelaide demonstration project may have few spin-offs.

Although Japanese investment activity in the Australian manufacturing sector and transfers of production technology have been comparatively limited, there have been some success stories. A Japanese food processor, for example, set up a pilot farm in conjunction with a local beef packer to raise cattle and provide beef cuts that meet Japanese taste preferences. The company also cooperated in marketing the beef in Japan. In another case a Japanese automotive maker designed a 3000-cc car for production in Australia, some of which have been exported to Japan. This type of car fills a niche in Japan, where demand for high-quality, powerful cars is on the upswing. In a final example a Japanese electronics company has launched a joint research program in robotics and computer software technologies with the Australian National University, which has a well-established reputation in basic scientific research.

Increased Japanese investment activity and technology sharing depends on Australian enthusiasm for the multifunction polis concept and Canberra's willingness to provide a framework that encourages exports of manufactured products as well as a positive investment climate and adequate infrastructure. What Japanese companies may view skeptically are government-led projects. Understanding corporate Japan's relationship with government -- both the extent of cooperation and the limits of persuasion -- is as important to the Australian public and private sectors as an understanding of Australian attitudes is to potential Japanese investors.

Tourism and Mutual Understanding

The influx of Japanese tourists to Australia and the substantial investments there in real estate and tourism-related industries by Japanese companies have generated a great amount of local concern. Tourism from overseas generally not only stimulates related service industries but also may promote deeper understanding between people of different cultural backgrounds. A rapid increase in tourists from a particular country converging on selected sightseeing spots, however, has been known to cause problems with the host country's residents.

Japanese visitors to Australia surpassed the 300,000 mark last year, at least triple the number of five years ago. Although Japanese tourists going to Australia amounted to barely 3.2 percent of the total taking trips abroad in 1990, Australia is an increasingly popular destination. The gaggle of Japanese entertainment magazine reporters and television crews that followed a popular singer and actress who spent their honeymoon in Australia in 1987 helped to popularize the country for many Japanese honeymooners. The 1988 leisure exposition in Brisbane also attracted many young Japanese men and women, the group perhaps most willing and able to spend time and money on vacations abroad.

Accompanying the influx of tourists were Japanese investors. They bought luxury hotels, condominiums, golf courses and gift shops along the Gold Coast, the Great Barrier Reef and other famous sightseeing spots. Purchases of a zoo that houses Australia's distinctive koala and a whole coral island stirred worries that Australians were losing ownership of their landmarks.

Beyond these fears was the inflationary impact of Japanese investment in tourism-related real estate. The cost of housing, land and even golf course fees jumped, resulting in, according to one news report, many young Australians giving up the idea of owning their own home or playing golf in spots frequented by sightseers. Similar critical articles and television programs have described Japanese honeymooners as flying in groups on a Japanese airliner to Australia where they travel on chartered buses with other Japanese couples and a Japanese tour guide, rush to a famous beach but stay only half an hour -- long enough to take a picture, stay in a Japanese-managed luxury hotel, and finally buy lots of gifts, many of which are made in Japan.

As exaggerated as these descriptions may be, they imply that Australians see Japanese tourists as interested in the country's natural attractions to the exclusion of Australian culture, the way of life there or society as a whole. This impression stems not just from how Japanese investors appear to be taking advantage of Australia's heritage. In the mid-1980s MITI proposed a Silver Columbia plan, designed to ease the strain on Japanese housing and services and to allow Japanese senior citizens the experience of living abroad, possibly in a more spacious and less costly country than Japan. When MITI unveiled the plan and included Australia as a potential destination without consulting Canberra, strong opposition surfaced among many Australians. The idea that about 100 families would live in a planned community with Japanese-managed stores, Japanese doctors and other signs of what appeared to be an exclusive Japanese colony in Australia struck residents as alien to their goal of being a multicultural society that seeks to harmonize people from different backgrounds. Although MITI immediately withdrew its plan, this episode overlapped with images of Japanese packaged tours advancing on Australia and added to Australian unease.

Another indication of the lopsided relationship between Australia and Japan is the extent of academic research on each other's politics, economy and culture. Many Australian universities have faculty grounded in Asian studies. Research on Japan ranges from classical novels to modern management skills. Moreover, Japanese is one of the most popular foreign language courses in Australian high schools.

Few Japanese academics, however, are interested in Australia. An association for Australian studies was organized just two years ago in Japan. In addition, while Australia's news media carry stories almost daily from Japan, only a few Japanese newspapers and broadcast stations follow events in Australia, even one as big as this month's high-level bilateral meeting in Canberra, attended by six ministers and two vice ministers from Japan.

Political Relations May Expand

The early May ministerial-level talks in Canberra attracted far more attention from Japanese officials than has been evident in the past. Tokyo is interested in playing a more active international political role in the post-Cold War world, one that befits its economic power. One potential forum involving

Australia is the Asia Pacific Economic Cooperation conference. Proposed by Australian Prime Minister Hawke in January 1989 as a Pacific counterpart of the Paris-based Organization for Economic Cooperation and Development, APEC has taken shape slowly. The group's primary focus is the development of economic ties among Asian Pacific countries, not creation of a trade bloc. The European Community and the proposed free trade zone encompassing the United States, Canada and Mexico, however, have given added impetus to creation of an Asian Pacific entity. Japan's position as the only Asian nation among the Group of Seven industrialized democracies and the sole Asian member of the OECD (Australia and New Zealand, while also OECD members, are considered part of Oceania) -- not to mention the size of its economy -- makes it a natural linchpin for an Asian-based trade group.

Although Canberra has courted ties with Japan for a regional grouping and investment in manufacturing, Australian officials do not see eye-to-eye with their Japanese counterparts on certain issues. That is especially true of agricultural trade reform. Australia is one of the leaders of the Cairns group, which has pushed strongly in the Uruguay Round for an end to agricultural production and export subsidies as well as the removal of import barriers. Japan, however, has stuck to the position that countries should be allowed to retain quotas or other import restrictions on some commodities for food security reasons.

In the security area Australia, on occasion, has been less willing to forget Japanese aggression during World War II than other nations. In fact, a primary motivation behind the 1951 security treaty signed by Australia, New Zealand and the United States was to prevent Japan from becoming an aggressor again in the Pacific. Recently, however, Australia indicated it welcomed Tokyo's decision to send minesweepers to the Persian Gulf after hostilities ended there. Tokyo and Canberra also have cooperated on several regional peace plans, such as the Cambodian peace talks, although Tokyo has shown little interest in Canberra's proposal for comprehensive regional security arrangements or an Asia-based counterpart to the Conference on Security and Cooperation in Europe.

Conclusion

As often happens with economic superpowers, relations with neighboring countries can be lopsided. Japan's gross national product is more than 10 times bigger than Australia's. And while bilateral trade makes up almost a quarter of Australia's two-way trade, it represents only about 4 percent of Japan's overall exports and imports. Since Japan's economic influence on Australia, whether through trade, investment or tourism, is more extensive than Australia's economic impact on Japan, it is not surprising that Australians pay considerable attention to, and are cautious about, Japanese attitudes and views.

The mutually supportive Japan-Australia trade relationship has not necessarily resulted in mutual benefits for the two participants. Although both governments have taken steps to encourage Australia's manufacturing sector, those moves have been frustrated to some extent by other problems, including limited interest in collaboration among many members of Japan's business community.

Until recently both American and Japanese commentators on their respective country's economic relations with the other have tended to focus on the transpacific trade imbalance. The imbalance, however, is only one of the problems straining the U.S.-Japan relationship. Unlike the Japan-Australia case, the U.S. economy remains almost twice as large as Japan's. Many Americans, however, view the U.S.-Japan relationship as symbolic of a shift in comparative economic power. In this context, Japan's influence on the American economy often is exaggerated in American attitudes. Similarly, Australian complaints about Japan carry echoes of Americans' perceptions of Japan.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 20B
May 24, 1991

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Faction Leader's Death Sparks Political Maneuvering

Despite outward shows of courtesy and politeness, Japanese politicians have proven to be as ruthlessly competitive as that Italian political mastermind Machiavelli could have wished. Only days after the May 15 death of former Foreign Minister Shintaro Abe, ruling Liberal Democratic Party officials began maneuvering to seize the leadership mantle from Prime Minister Toshiki Kaifu, who first won his current status as a compromise candidate. Even though he had been hospitalized for bile duct surgery in May 1989 and in poor health in recent months, Mr. Abe had been viewed by many ruling party members as next in line to succeed Mr. Kaifu. When Mr. Abe, who led the second-largest LDP faction, died, the struggle among the biggest factions for leadership honors came into the open. The end result of this intraparty competition will not be known until the fall, but the party presidency and premiership could go to Noboru Takeshita, under whose wing Mr. Kaifu reportedly holds his position. Mr. Takeshita was forced to relinquish the twin posts two years ago due to his involvement in the Recruit Co., Ltd. influence-peddling scandal. Mr. Kaifu, who is not a in drawing up a new bill that would be considered in the upcoming extraordinary Diet session.

As before, the stumbling block continues to be who should serve on the team. Late last year a consensus appeared to develop among the three parties that only civilians would be allowed to participate. SDF leaders, however, would like their men to participate and, in fact, many supporters of the concept believe trained personnel would be a boon for the team. A number of LDP members have pushed for SDF participation. Earlier this year the DSP said that it would support such an arrangement if SDF team members were on leave from the armed forces or on loan (see JEI Report No. 10B, March 15, 1991). Support in the government for SDF inclusion in some form on the U.N. peace cooperation team surfaced in a May 21 speech by Mr. Kaifu in which he indicated support for an SDF role in U.N. peacekeeping missions and in comments from senior Foreign Ministry officials May 24. Komeito, which holds the critical swing votes in the upper house, has remained noncommittal on the membership issue.

Foreign Minister Taro Nakayama added another wrinkle May 14 to the peaceful use of SDF troops abroad by proposing that the law governing the dispatch of disaster relief teams overseas be revised to allow participation by SDF personnel. He further suggested that the debate on revising the 1987 disaster relief law could be conducted simultaneously with discussions on establishing the new organization to support U.N. peacekeeping activities.

In an effort to better organize the debate and avoid potential logjams LDP secretary general Keizo Obuchi proposed May 17 a new LDP research council to hammer out a bill. Mr. Obuchi apparently shares the prime minister's views about allowing military personnel to participate in U.N.-sponsored activities. The LDP secretary general named his predecessor, Ichiro Ozawa, to head the group. Mr. Ozawa was the driving force behind the original peace team plan and a main backer of SDF participation.

Government officials and LDP leaders apparently hope that the Japanese people will be more accepting of an expanded international role for the SDF in the aftermath of the gulf war. Public reaction was not unfavorable when the Japanese government in late April took the unprecedented step of dispatching a small flotilla of minesweepers to the Persian Gulf to assist with postwar mop-up operations (see JEI Report No. 17B. May 3, 1991). But once again Komeito appears to hold the trump card. If the second-largest opposition party continues to hold out, Mr. Kaifu may face yet another setback in his effort to guide Japanese foreign policy in a new direction.

Barbara Wanner

Japan's Personal Savings Dip As Overall Rate Holds Steady

In some quarters Japan's consumers are seen as having become remarkably profligate, abandoning their former frugality. Data released at various times over the past six months provide some support for such a view but also suggest that the implications are limited. As shown in the first column of the table, the personal savings rate has declined in Japan in recent years. While comparable data for 1990 are not available, the downward trend most likely continued. The figures in the first column are the basis of the widely held view that the

Japanese Savings and Investment Data, 1976-89

	Personal Savings Rate*	Overall Net Savings/ GNP	Overall Net Investment/ GNP	Adjustments**/ GNP	Net Lending to Rest of World/ GNP
1976	23.2%	20.2%	19.4%	-0.1%	0.6%
1977	21.8	19.6	18.5	0.4	1.5
1978	20.8	20.0	18.7	0.3	1.7
1979	18.2	19.0	20.0	0.1	-0.9
1980	17.9	18.3	19.5	0.1	-1.0
1981	18.4	18.3	18.0	0.1	0.4
1982	16.7	17.1	16.5	0.0	0.7
1983	16.1	16.2	14.4	0.0	1.8
1984	15.8	17.2	14.4	0.0	2.8
1985	15.6	18.1	14.5	0.0	3.6
1986	16.1	18.1	13.9	0.0	4.2
1987	14.7	18.5	14.5	-0.4	3.6
1988	14.3	19.7	16.4	-0.5	2.7
1989	14.2	19.5	17.1	-0.5	2.0

*Household savings/household disposable income.
**Statistical discrepancy and capital transfers.

Note: Net lending to rest of world -- the result of net savings minus net investment plus adjustments -- is equivalent to the external surplus.

Source: Calculated from data in Economic Planning Agency, Annual Report On National Accounts (Tokyo: Okura-sho Insatsu-kyoku, 1991).

personal savings rate in Japan, while still high, is approaching that of several other industrialized countries, such as West Germany's 12.5 percent rate in 1989. (In the United States savings were 4.6 percent of personal disposable income in both 1989 and 1990.) The personal savings rate is equal to the portion of household income (net of taxes but including such income supplements as social security) that is not spent on consumer goods and services.

Households, however, are not the only savers in Japan or elsewhere. For example, corporations save to the extent that they do not pay out all of their income in dividends. Even governments are potential savers if tax receipts exceed spending on those goods and services that are analogous to a household's day-to-day expenditures. The second column of the table takes all these additional sources of savings into account. (Conceptual differences in seemingly comparable U.S. data render comparisons difficult by understating U.S. overall savings behavior.) Because Japanese firms and the government have increased their savings in recent years, declining household savings pushed aggregate savings down only slightly between 1976 and a low point in 1983. If anything, the overall rate has increased modestly in recent years.

The remaining columns of the table show the disposition of savings in Japan. Most have gone to increase the size of the Japanese capital stock, as shown by the figure for net investment; this differs from the more commonly used gross investment figure in that the net data do not include funds to replace capital stock that wears out or becomes obsolete. Gross investment and its savings counterpart -- savings plus the capital consumption allowance -- are substantially higher than the net savings and investment shown.

In another difference from common practice, the table incorporates overall investment regardless of purpose or source. Figures for 1989 show that 19 percent of Japanese investment went for housing, 15.8 percent for government-type investment and 2.4 percent for inventory accumulation; the remainder, 62.8 percent, went for plant and equipment spending by the corporate sector and, to a lesser extent, the government sector as well as by unincorporated businesses. The effect of using an inclusive definition of investment is to make the figure far higher than that for a single category, such as corporate plant and equipment spending.

The last column of the table, which shows surplus savings available for investment abroad, may be of the most interest to Americans. Between 1976 and 1982 the figures in this column remained relatively small as net investment and net savings declined in tandem. Between 1984 and 1986, however, overall savings rates stabilized while investment continued to decline. The result was larger surplus savings, reflected in bigger net outbound capital flows and their mirror image, larger external surpluses. In 1987 the pattern changed again as investment began to grow rapidly, eating into the savings surplus and leading to a smaller external imbalance. (The external surplus is similar to but slightly broader conceptually than the current account surplus.) Preliminary data suggest that this trend continued into 1990.

Overall the table suggests that changes in the personal savings rate have not been the dominant factor in determining overseas capital flows. Even overall savings are of limited importance. Rather, the dominant factor appears to be changes in investment behavior, particularly in recent years. With the prospect that investment spending is leveling off in Japan, this argument suggests that the external imbalance may change relatively little in the next year or two.

The direction of Japan's external imbalance also will depend on factors other than domestic savings and investment intentions. The early 1990s may witness a reprise of sorts of the mid-1980s when Japan's ballooning current account surpluses were in part a consequence of funds being pulled abroad by high real interest rates. The U.S. federal budget deficit could swell in response to antirecessionary spending coupled with sluggish tax receipts at the same time that Bonn's spending to reconstruct the former East Germany drains the German surplus. In addition, capital demands in Eastern Europe and the Middle East are likely to rise. The effect of such a worldwide capital shortage would be to raise real interest rates and pull funds out of Japan. The response in Japan would be less domestic investment or more savings, or both, compared to otherwise. In turn, a larger external surplus would follow.

Douglas Ostrom

New Twists In EC-Japan Ties

The May 22-25 visit by European Community Commission President Jacques Delors to Tokyo will offer him a chance to discuss bilateral tensions with

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REPORT

A Two-Part Report: A and B

NO. 21A June 7, 1991

U.S.-JAPAN COMPETITION IN SEMICONDUCTOR MANUFACTURING EQUIPMENT: THE CONSEQUENCES OF SHIFTING POSITIONS

Summary

American suppliers of semiconductor manufacturing equipment are in trouble, dangerously close to being permanent runners-up to Japanese makers in a business they dominated a few years ago. True, U.S. companies still have an edge in a cross section of wafer fabrication, assembly and test technologies. But staying ahead of Japanese rivals in these areas and regaining lost ground in other products critical to the semiconductor production process will be hard.

Domestic SME makers are hobbled by many of the same disadvantages that hamstring other American electronics manufacturers, including limited funds for research and development. Weak working relationships between semiconductor makers and their equipment suppliers compound these problems. More important perhaps, the U.S. industry's competitive handicaps often play to the strengths of Japanese SME companies.

The clouded outlook for the American SME industry has triggered new worries in Washington and Silicon Valley about the ability of the United States to remain in contention with Japan for international leadership in semiconductors. The industry's uncertain prospects also have led to one study after the other. A common conclusion runs between the lines of these reports: U.S. dependence on SME suppliers that get most of their business from big Japanese chip manufacturers is a high-risk strategy.

That consensus has politicized recent U.S. discussions of transpacific competition in semiconductor equipment. At the same time, however, it has set in motion some overdue changes that

should bolster the domestic industry's competitive position, including improved semiconductor producer-SME supplier ties and a stepped-up marketing effort in Japan.

Trading Places

Eleven years ago American suppliers were the undisputed leaders in semiconductor manufacturing equipment. They still generally were the companies to beat in the mid-1980s. Today U.S. makers of wafer fabrication, assembly and test gear have to fight hard just to stay in the race. Domestic producers ended 1990 with 45 percent of the $9 billion-plus world SME business, according to preliminary data compiled by industry watcher VLSI Research Inc. That put them in a dead heat with their Japanese rivals, a dramatically different finish from 1980 when American suppliers controlled 75 percent of the $2.1 billion global market and Japanese firms had an 18 percent share.

Despite the nonstop erosion in the U.S. industry's competitive position during the 1980s, domestic manufacturers still supply anywhere from 70 to 80 percent of the equipment bought by semiconductor makers operating in the United States. Government and industry analysts are quick to point out, however, that this figure is a deceptive indicator of both the current health and the future prospects of U.S. suppliers. For one thing, the American SME market, twice as big as its Japanese counterpart at the start of the 1980s, is now 15 to 20 percent smaller than Japan's. More important, U.S. companies are being squeezed in the expanding Japanese market where their share is running around 15 percent, down from the 40 percent range of the early 1980s.

The most accurate gauge of the U.S. industry's present competitive position, though, is its number-two ranking in the strategic market for wafer fabrication or front-end equipment. A recent report by Dataquest Inc., another Silicon Valley research firm, credited American vendors with only 37 percent of the $5.8 billion worth of processing gear sold worldwide last year; their Pacific rivals' share was put at 51 percent. This outcome, almost the reverse of 1985's, partly reflects far greater demand for wafer fabrication equipment in Japan than here, but it owes more to a fundamental U.S. weakness: American companies are also-rans in the make-or-break area of microlithography equipment, the machines that print circuit patterns on silicon wafers.

Nikon Corp. alone controls roughly half of all sales of wafer steppers, the system of choice for handling the micron or submicron line widths of today's leading-edge logic and memory chips. Canon Inc. has another 20 percent or so of the market for this type of optical (light-based) lithography equipment, also known as step-and-repeat machines. Moreover, latecomer Hitachi, Ltd. is closing in on the share held by General Signal Corp.'s GCA Corp. unit, the developer of the stepper.

American suppliers also come up short in diffusion furnaces. Tokyo Electron Ltd., Kokusai Electric Co., Ltd. and other Japanese companies have left

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Silicon Valley Group, Inc., BTU International Inc. and their U.S. counterparts with only a third of the world market. Although certainly a troubling development, this second-place showing is not a critical weakness for the U.S. industry because diffusion furnaces are an older method for imparting dopants, or impurities, onto wafers. Varian Associates, Inc., Eaton Corp., Applied Materials, Inc. and Genus Inc. dominate sales of the new technology, ion implanters, controlling three-fourths of the world market.

U.S. companies also are the current leaders in deposition equipment, second in sales volume only to microlithography systems, as well as in etch equipment, the third-largest segment of the wafer fabrication business. In general, though, domestic players are being pressed hard by Japanese and, in some products, European competitors. Of the different types of deposition equipment -- which applies thin films of materials to wafers, giving them insulation and conduction properties -- American suppliers have the strongest presence in chemical vapor deposition machines. Applied Materials, the market leader, along with Genus, Novellus Systems Inc. and smaller firms split about 60 percent of world contracts. U.S. makers face more Japanese competition in physical vapor deposition or sputtering equipment. Nevertheless, led by Varian and Materials Research Corp. (a Sony Corp. subsidiary since 1989), they still have about half of the global market compared to a third for Ulvac Corp., Anelva Corp. and other Japanese producers. That also is the U.S. position in etching equipment. Today circuit patterns generally are etched onto wafers by dry processes, primarily plasma techniques. Here Applied Materials is the top supplier, with Lam Research Corp. number three and TEL in between.

A generally disquieting picture emerges from this welter of numbers: at best American suppliers maintain a narrow lead over their Japanese rivals; at worst they have to play catch-up if they are to get back into the game. This is a difficult, perhaps impossible job, particularly in the technically demanding, capital-intensive area of microlithography. The same is true in test equipment and assembly equipment. Advantest Corp., Ando Electric Co., Ltd. and other Japanese companies dominate the market for logic test systems, the biggest test equipment segment, limiting the share of Schlumberger Ltd.'s ATE division, the main U.S. competitor, to a figure in the teens. If anything, Japanese control over world sales of memory testers -- Advantest's strength -- is more complete. Only in linear and mixed-signal test systems are American manufacturers the market leaders, with Teradyne, Inc. and LTX Corp. divvying up about two-thirds of the orders. In assembly equipment, the smallest part of the SME business, Kulicke & Soffa Industries Inc., the top U.S. player, comes in second in wire bonders to Shinkawa Ltd., which also is number one in older die bonders.

VLSI Research's annual ranking of the world's biggest SME companies provides a good summary of the shifting positions of the American and the Japanese industries over the past decade. In 1980 U.S. suppliers took the first nine places; Advantest was the only Japanese firm to make the cut. Last year the list was split five and five. TEL won the top spot, nosing out Nikon. Applied Materials was the highest-ranked American firm at number three. The four other U.S. firms to make the list -- General Signal, Varian, Teradyne and SVG -- were at the bottom, behind the Japanese trio of Advantest, Canon and Hitachi.

An Unequal Match?

Given the interdependence of semiconductor makers and their equipment suppliers, the proximate cause of the loss of U.S. leadership in the world SME market is no farther away than the decline of the American chip industry over the course of the 1980s. At the start of the decade this country's merchant semiconductor makers captured 58 percent of global sales, more than double the figure for their Japanese competitors, Dataquest calculated. The tables turned in 1986, and by last year U.S. companies had only 37 percent of the business versus a 50 percent share for Japanese manufacturers.

That reversal, accelerated by a surge in capital spending by Japanese chipmakers, gave Japan's SME suppliers the built-in advantage of a growing home market. Their big break, though, was the rapid expansion of domestic production capacity for dynamic random access memories, particularly in the 1984-85 period (the switchover to 256-kilobit devices) and in the 1988-89 time frame (the beginning of the 1-megabit era). The huge amount of money earmarked for equipment to make DRAMs meant quantity orders for Japanese SME producers, certainly a competitive plus. The impact on process technologies, however, was more significant.

DRAMs normally are the proving grounds for production equipment, whether wafer fabrication, assembly or test gear, in part because they are high-volume products but mainly because these chips are the cutting edge of the complexity envelope. Having to develop equipment that could handle the ever-denser designs Japanese DRAM manufacturers devised during the 1980s gave domestic SME suppliers a leg up in memories as well as logic chips.

The competitive benefits of a big domestic market centered on DRAMs notwithstanding, U.S. government officials and electronics industry executives argue that Japan's SME suppliers have some distinct advantages over their American rivals. Near the top of their list is the structure of the two countries' industries. In the typical, if slightly exaggerated, description small U.S. companies are matched up against big Japanese competitors. In fact, the size distribution of the two industries is remarkably alike.

In both countries only a handful of firms have more than $200 million in SME sales a year. In Japan that group consists of TEL ($902.3 million, including imports, in the year through September 1990 at Y135=$1.00), Nikon ($589.4 million in FY 1989), Advantest ($416.9 million in FY 1989), Canon and, recently, Hitachi. On the American side companies crossing the $200-million-a-year threshold include Applied Materials ($567.1 million in the year ending October 1990), General Signal (roughly $400 million in 1989), Varian ($298 million in the October 1989-September 1990 period) and Teradyne.

The ranks of medium-sized suppliers (companies doing between $50 and $200 million a year in SME business) are slightly larger in both Japan and the United States but still relatively equal in number. This category encompasses such manufacturers as SVG, LTX, Lam, Eaton, MRC, Genus and Kulicke & Soffa on the U.S. side and Ulvac, Anelva, Shinkawa and Kokusai in Japan. The structural similarities extend down to the bottom tier of SME makers -- companies generating less than $50 million a year in sales. Both industries have large groups of small companies. The difference is the far higher number of U.S. manufacturers in this segment. A 1988 VLSI Research survey identified 227 American SME suppliers with annual sales of less than $50 million; the comparable figure for Japan was 76.

Firm size enters into the competitive equation several ways. For example, small SME companies are particularly hard-pressed to weather cutbacks in capital spending by chip producers, such as the 1986-87 downturn in investment by semiconductor makers in both Japan and the United States. Where firm size perhaps makes the biggest difference, however, is in funding research and development. Here, indirect evidence suggests, nationality does matter.

Because of rapid changes in semiconductor technology, the product cycle in the SME business is short. A new generation of equipment must be produced every three years on average and that, according to one estimate, costs at least $50 million for manufacturers of wafer fabrication equipment. Meeting these demands while simultaneously developing new process applications for existing products obviously requires a high rate of R&D spending year in and year out.

Overall, various surveys indicate, American SME suppliers spent approximately 14 to 16 percent of annual sales on R&D in the second half of the 1980s -- a ratio roughly four times the average for the U.S. manufacturing sector as a whole. Underwriting that level of spending year after year strains corporate finances. In the 1985-87 period, in fact, R&D funding was at the expense of industry profits. Big and midsized SME manufacturers at least have fairly substantial internal sources of funds to tap. By definition the numerous small American makers do not have the in-house financial wherewithal to fund new product and process technologies on their own. They are dependent on external capital, and loans, if available, are expensive and patient investors scarce.

The tremendous costs of being a competitor in the SME market lead to periodic shakeouts in the domestic industry -- not just of marginal companies but name players as well. For instance, Allegheny International Inc. sold Thermco Systems Inc., an old and important maker of diffusion furnaces, to Silicon Valley Group in 1988 after deciding that it no longer could afford to stay in the SME business. Beleaguered GCA was put up for sale the same year; the maker of wafer steppers and other processing equipment, bought by General Signal, never fully recovered from a flood of red ink in 1985 despite a major 1986-87 financial bailout and restructuring.

The financial pressures on American SME companies are best illustrated, though, by Perkin-Elmer Corp.'s April 1989 decision to exit the business. A pioneer in microlithography systems, the company was the world's biggest semiconductor equipment vendor through 1986. By the time the SME division was put on the market Perkin-Elmer had spent eight years and a reported $100 million on the development of a new type of optical wafer stepper for 16- and 64-megabit DRAMs, known as a step-and-scan system, but it still needed to invest many millions more to get the Micrascan to market. In calling it quits, Perkin-Elmer executives cited the enormous costs of developing new products and doubts about the company's ability to recoup its investment in the Micrascan.

Perkin-Elmer's troubles finding an American buyer for its semiconductor equipment business, which included an electron-beam lithography line as well as the optical lithography operations, underscore the precarious nature of the domestic SME industry. Several U.S. companies made offers, but their bids fell short of Perkin-Elmer's asking price. Nikon also entered into talks with the firm. That move triggered a backlash among American semiconductor manufacturers and equipment suppliers, and the Japanese wafer stepper maker pulled out of the discussions.

Two groups of U.S. buyers finally were put together with the behind-the-scenes assistance of International Business Machines Corp., which had helped Perkin-Elmer financially and technically with the development of the Micrascan. A new SVG subsidiary acquired a majority share in the optical lithography unit in May 1990. Although IBM, the world's largest captive maker of chips, did not participate in the buyout, it did agree to take all of SVG's Micrascan output for four years and to provide development funding. IBM did take a stake along with Perkin-Elmer and four other companies in Etec Systems Inc., formed in March 1990 to run the electron-beam lithography operations. In addition, the computer giant promised to transfer some of its E-beam technology to Etec.

Government and industry officials in the United States argue that the financial problems that cause restructuring in the American SME industry are absent in Japan. They are right, but their reasoning sometimes is flawed. Although industrywide figures on R&D spending by Japanese SME suppliers are not available, selected company data suggest that Japanese competitors as a group do not invest as much in R&D as American manufacturers, either relative to sales or in absolute terms. If this conclusion is correct, then some of the pressure is off Japan's industry. The fact remains, however, that Japanese SME companies still must put substantial amounts of money into R&D to remain competitive.

Most R&D spending in Japan is funded internally, just as it is here. The critical difference is that Japanese semiconductor manufacturers share some of the costs of developing new product and process technologies with their equipment suppliers. This cooperative R&D approach transcends company size; big names like Nikon and Canon are just as likely to work with Japan's major chipmakers as small SME companies. It also cuts across equity linkages; for example, Ulvac, partly owned by Matsushita Electric Industrial Co., Ltd., does not depend solely on the electronics giant for help. Moreover, Japan's many small SME makers, which generally are unaffiliated with the country's industrial groupings or keiretsu, receive financial and technical support from big semiconductor producers.

Japanese SME suppliers readily admit that their working relationships with chip producers -- which provide help with product planning and equipment testing in addition to financial and technical development support -- are a major competitive advantage. In fact, they rank close customer involvement as their biggest strength, not home market size or any of the other factors that U.S. electronics industry representatives are likely to put at the top of the list of Japanese advantages. At the same time Japan's SME makers say the U.S. industry's main problem is the poor relationship between American equipment manufacturers and chip producers rather than the cost and/or the availability of capital, the usual candidate.

Japanese semiconductor equipment vendors have at least one other quarrel with most American lists of their industry's competitive advantages and that concerns the role of government funding in R&D. True, the frequently cited VLSI (very large-scale integrations) project -- a joint effort by the Ministry of International Trade and Industry and Japan's big computer makers to develop product and process technologies for what then was the next generation of memory devices -- gave Nikon and some other suppliers their introduction to the SME business. But the VLSI project ended in March 1980. Moreover, the work of commercializing the techniques developed was left to the project participants.

If pressed, U.S. government and industry officials probably would acknowledge that no Japanese equipment since the first generation has had the benefit of MITI R&D funding. They have found a new cause for worry, though, in the form of three government-backed programs to develop X-ray lithography systems for possible use when optical equipment no longer can draw circuit lines as finely as needed. All of these efforts -- such as a FY 1986-FY 1995 project 70 percent funded by a MITI-affiliated research organization and including Japan's 10 biggest chipmakers plus Nikon and Canon -- involve the use of synchrotrons, or accelerators, to generate beams of X-rays from speeding atomic particles. Researchers point out, however, that synchrotrons are neither a straightforward nor an inexpensive way to produce chips. In addition, the U.S. government is funding comparable research through the Department of Defense's Defense Advanced Research Projects Agency and the Department of Energy -- and, it appears, at a higher level.

Japanese SME makers also take exception to the now conventional wisdom that they and other Japanese companies have undermined the American SME industry by buying up key suppliers. Only one equipment manufacturer is wholly owned by a Japanese firm, Materials Research, and Japanese investors have minority stakes in just four other industry players (see Table 1). Moreover, all of these companies turned to Japanese businesses after they failed to find patient U.S. investors. Including purchases of companies that manufacture peripheral equipment for chip production, such as the controversial takeover of gas cabinet maker Semi-Gas Systems Inc. (Table 2), still does not add up to the claimed "avalanche" of Japanese acquisitions.

Japanese investors have been more active in the U.S. semiconductor materials industry (Table 3) than in its SME counterpart. Here, American concerns about changes in ownership are more understandable. Japanese suppliers already had dominant world market positions in some segments of the materials industry -- ceramic packages, leadframes, sputtering targets and silicon wafers, for example -- before they bought out their U.S. competitors, including companies that were the last or one of the few remaining major American makers of a particular product. Japanese ownership, however, does not mean that U.S. device manufacturers will be cut off from their suppliers or that Japanese chipmakers operating in the United States suddenly will get preferential treatment.

Exaggerating some of the things Japanese companies in a particular industry are doing or the competitive impact of these actions on American manufacturers often is a tactical move, designed to get help from Congress and/or the White House for U.S. suppliers. The claims that government R&D funding is a key to Japan's strength in production equipment and that Japanese acquisitions are a cause of the American SME industry's problems fall into this category. Perhaps the best example of this strategy, however, is the recent charge by SEMATECH that some Japanese SME suppliers have withheld state-of-the-art equipment from U.S. chipmakers while making it available to Japanese competitors. Even domestic semiconductor makers have hinted that the Texas-based government-industry consortium, which is developing advanced semiconductor manufacturing technologies, was publicizing this claim to build support in Washington for additional funding.

Improving the Odds

The decline of the American SME industry over the 1980s and the prospects for more of the same this decade have led to a spate of government and industry studies. Like SEMATECH, all of them warn that dependence on Japan for key pieces of wafer fabrication, assembly and test equipment endangers the viability of the U.S. semiconductor industry and, by extension, the whole American electronics sector. Common policy prescriptions for a resurgent SME industry also run through these reports, but different priorities are assigned to these recommendations. Report drafters affiliated with the semiconductor industry emphasize tax changes to increase the availability of capital and/or lower its cost, including permanent R&D tax credits and cuts in the capital gains tax. SME manufacturers put closer customer-supplier relations and a bigger marketing effort in Japan at the top of their lists.

Partnering - American SME manufacturers say their Japanese competitors are right on target in citing poor relations between chipmakers and equipment suppliers as the U.S. industry's main weakness. Big semiconductor producers acknowledge that they have to work more closely with equipment suppliers, involving them early in the product development cycle, assuming some of the costs and risks of developing next-generation equipment, providing feedback on equipment performance -- in short, doing what Japanese semiconductor makers do. But changes in the way U.S. chip companies do business have come slowly, largely because cooperation among manufacturers runs counter to the American corporate culture. With the help of SEMATECH, however, some positive signs are starting to appear.

Established in 1987, SEMATECH mapped out a three-stage, five-year R&D plan for regaining U.S. world leadership in semiconductor manufacturing technologies by the middle of 1993. Helping SME suppliers was low on the consortium's initial agenda, but its 1991 operating plan lists assistance for equipment makers as the organization's second objective. That new ranking has been backed up by increased funding for outside work on the development of next-generation production equipment and improvements in existing gear. About half of SEMATECH's annual budget of roughly $200 million, financed in equal parts by DARPA and the group's 14 semiconductor and computer company members, currently is earmarked for contracts with SME manufacturers, versus 20 percent in the early phases. Perhaps just as important, SEMATECH has established several forums for the exchange of technical information among its corporate members and equipment suppliers. It also has designed guidelines for long-term cooperative relationships and instituted a review process to assess how much progress its 14 participants have made in forging closer ties with their key American equipment vendors.

Although encouraged by these steps, many equipment makers say it will take more than the SEMATECH programs to get them back on track. As a case in point they cite Motorola Inc.'s decision last fall to buy Canon's latest generation of optical steppers for its new wafer fabrication facility in Austin, Texas instead of ordering a competing GCA model. That machine was developed with SEMATECH financial support and the technical assistance of several of the consortium's participants. Moreover, Motorola was one of four member companies that tested prototypes of the GCA stepper in actual manufacturing environments. American SME suppliers argue that if orders for critical equipment like steppers go to Japanese builders, the U.S. industry's decline will continue regardless of what SEMATECH does. Big semiconductor makers like Motorola and IBM, which ordered three of the Canon steppers earlier this year, reply that they are in a bind: while anxious to maintain domestic sources of supply, they have to buy the best product on the market -- even one made in Japan -- to remain competitive in their own business.

Table 1: Acquisitions of or Investments in U.S. Semiconductor Manufacturing Equipment Makers by Japanese Companies

U.S. Company	Headquarters	Japanese Company	Share	Product Line	Year
		Majority Interest (50-100 Percent)			
Materials Research Corp.	Orangeburg, NY	Sony Corp.	100%	Sputtering/etching equipment	1989
		Minority Interest (10-50 Percent)			
Mattson Technology Inc.	Sunnyvale, CA	Marubeni Hytech Corp.	20	Photoresist striping equipment	1991
LTX Corp.	Westwood, MA	Sumitomo Metal Industries, Ltd.	15	Linear, digital/mixed-signal test equipment	1990
Lepton, Inc.	Murray Hill, NJ	Canon Inc.	10	Electron-beam lithography equipment	1990
AG Associates	Sunnyvale, CA	Canon Sales Co., Inc.	30	Rapid thermal processing equipment	1989
		Financial Interest (Under 10 Percent)			
Prometrix Corp.	Santa Clara, CA	Sumitomo Corp.	3	Metrology equipment	1990
Lam Research Corp.	San Mateo, CA	Sumitomo Metal Industries, Ltd.	4.5	Plasma etching/deposition equipment	1989
Novellus Systems Inc.	Santa Clara, CA	Seki & Co., Ltd.	n.a.	Deposition equipment	1988

Source: Japan Economic Institute

Table 2: Acquisitions of or Investments by Japanese Companies in U.S. Makers of Equipment Related to Semiconductor Production

U.S. Company	Headquarters	Japanese Company	Share	Product Line	Year
		Majority Interest (50-100 Percent)			
Semi-Gas Systems Inc.	San Jose, CA	Nippon Sanso K.K.	100%	Gas-handling equipment	1991
Matheson Gas Products, Inc.	Secaucus, NJ	Nippon Sanso K.K.	100	Gas-handling equipment	1989
Siltec Corp., Cybeq/ Cybeq Systems Inc.	Menlo Park, CA	Mitsubishi Materials Corp. Mitsubishi Corp.	90 10	Wafer production/handling equipment	1986
Matheson Gas Products, Inc.	Secaucus, NJ	Nippon Sanso K.K.	50	Gas-handling equipment	1983

Source: Japan Economic Institute

Table 3: Acquisitions of or Investments in U.S. Semiconductor Materials Producers by Japanese Companies

U.S. Company	Headquarters	Japanese Company	Share	Product Line	Year
Majority Interest (50-100 Percent)					
U.S. Chrome Corp.	Stratford, CT	Japan Metals & Chemicals Co., Ltd.	100%	Chrome for metallizing	1990
Union Carbide Corp.'s polysilicon business/ Advanced Silicon Materials Inc.	Moses Lake, WA	Komatsu Electronic Metals Co., Ltd.	100	Polysilicon	1990
Texas Instruments Inc.'s photomask business/ Toppan Printronics (USA) Inc.	Dallas, TX	Toppan Printing Co., Ltd.	85	Photomasks	1990
Materials Research Corp.	Orangeburg, NY	Sony Corp.	100	Sputtering targets	1989
Micro Mask, Inc.	Sunnyvale, CA	Hoya Corp.	100	Photomasks	1989
General Ceramics, Inc.	Haskell, NJ	Tokuyama Soda Co., Ltd.	100	Ceramic IC packages	1989
Matheson Gas Products, Inc.	Secaucus, NJ	Nippon Sanso K.K.	100	Specialty gases	1989
Cincinnati Milacron Semiconductor Materials Inc./Cincinnati Semiconductor Inc.	Maineville, OH	Osaka Titanium Co., Ltd.	100	Silicon/epitaxial wafers	1989
Varian Associates, Inc.'s specialty metals division/ Tosoh SMD, Inc.	Grove City, OH	Tosoh Corp.	100	Sputtering targets	1988
U.S. Semiconductor Corp.	Fremont, CA	Osaka Titanium Co., Ltd.	100	Epitaxial wafers	1986
Siltec Corp., Siltec Silicon	Menlo Park, CA	Mitsubishi Materials Corp. Mitsubishi Corp.	90 10	Silicon/epitaxial wafers	1986
NBK Corp./Kawasaki Wafer Technology, Inc.	Santa Clara, CA	Kawasaki Steel Corp.	100	Silicon/epitaxial wafers	1985
Matheson Gas Products, Inc.	Secaucus, NJ	Nippon Sanso K.K.	50	Specialty gases	1983
Minority Interest (10-50 Percent)					
Aegis Inc.	New Bedford, MA	Asahi Glass Co., Ltd.	49	Metal IC packages	1987
Koltran Corp.	Sunnyvale, CA	Nippon Mining Co., Ltd.	36.7	IC leadframes	1985
Hemlock Semiconductor Corp.	Hemlock, MI	Shin-Etsu Handotai Co., Ltd. Mitsubishi Materials Corp.	24.5 12.25	Polysilicon	1984

Source: Japan Economic Institute

Sales in Japan - Major U.S. equipment makers recognized early on that a strong sales and service operation in Japan was a minimum requirement if they were to capitalize on the growing demand for wafer fabrication, assembly and test gear in the competition's backyard. Some went a step further, opening facilities to tailor products to customers' specifications or building manufacturing plants. In the first half of the 1980s at least five big or midsized companies went the production route, following a path blazed by Thermco in 1968 when it tied up with Tokyo Electron to make diffusion furnaces. Varian set up an equally owned venture with TEL in 1982 to turn out ion implanters; two years later Eaton formed a similar company with Sumitomo Heavy Industries, Ltd. to make the same product.

Another 50-50 venture, this one also established in 1984, linked BTU and Ulvac in the production of the U.S. firm's diffusion and oxidation furnaces. Materials Research made its move in 1983, starting production of sputtering systems in partnership with a small Japanese electronics company. Applied Materials took a different route, opening a wholly owned sales subsidiary in 1979 and then in 1984 adding a R&D center and a facility for final assembly and testing of its chemical vapor deposition and etch equipment.

These moves generally have been rewarded. Although admittedly atypical, Applied Materials has generated one-third to two-fifths of its total sales in Japan in recent years; in the year ending in October 1990 that translated into revenues of $189.3 million. Even if sales volume or market share do not live up to corporate expectations, having a Japanese production capability certainly is one reason companies like Applied Materials, Varian and Eaton have remained leaders in their fields.

A second investment wavelet started at the end of the 1980s as other American SME suppliers decided they had to gamble on a Japanese production operation to build sales. Machine Technology Inc., a small maker of sputtering systems, started production of its line in 1989 in a tie-up with a heavy equipment manufacturer. Last fall Kulicke & Soffa opened a technical center to do final assembly of its wire bonders as well as development work. Then in quick succession last winter test system maker Teradyne, which has had a Japanese R&D facility since 1984, said it would start local manufacturing in 1992, and wafer inspection systems supplier KLA Instruments Corp. announced that it also would begin production next year. They could be joined by LTX, which last spring signed a joint venture agreement with Sumitomo Metal Industries, Ltd. to manufacture, sell and support LTX testers.

Most of the other major American players in the SME business -- firms like General Signal, Silicon Valley Group and Genus -- have wholly owned sales and support operations in Japan. The large ranks of small U.S. equipment suppliers, however, generally are unrepresented in the Japanese market. These companies argue that they cannot afford the enormous costs of trying to crack that market even through a sales representative. But as one observer noted, small suppliers have little choice; that increasingly is where the orders are.

For further information, contact Susan MacKnight.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Table 1: Japan's Apparent Domestic Consumption of Semiconductor Manufacturing Equipment

(in millions of yen*)

Actual

	FY 1986	FY 1987	FY 1988	FY 1989
Total	Y233,555	Y274,333	Y458,922	Y469,462
Design Equipment	2,382	1,905	2,674	3,231
Mask and Recticle Production Equipment	6,876	7,465	8,614	11,206
Wafer Production Equipment	6,660	4,610	8,215	7,057
Wafer Processing Equipment	118,708	145,028	266,228	274,898
Lithography Equipment	32,556	43,357	88,381	71,529
Etching Equipment	13,795	17,864	32,191	40,698
Sputtering and Deposition Equipment	34,367	31,588	55,703	65,311
Oxidation and Diffusion Equipment, Ion Implanters, Scrub/Spin/Bake Equipment, and Metrology Equipment	37,990	52,219	89,953	97,360
Assembly Equipment	16,947	24,900	37,223	36,688
Test and Inspection Equipment	64,227	74,957	112,231	104,359
Test Equipment	39,569	52,339	74,692	66,635
Probing, Handling and Other Equipment	24,658	22,618	37,539	37,724
Other Equipment	17,755	15,468	23,737	32,023

Projected**

	FY 1990	FY 1991	FY 1992	FY 1993
Total	Y500,450	Y542,620	Y597,230	Y635,580

*The following average annual exchange rates can be used to convert the yen figures into dollars: FY 1986, Y159.84; FY 1987, Y138.35; FY 1988, Y128.26; and FY 1989, Y142.83.

**September 1990 forecast by the Semiconductor Equipment Association of Japan.

Note: SEAJ uses a broader definition of semiconductor manufacturing equipment than market researchers and analysts in the United States. They exclude design equipment, mask and recticle production equipment, wafer production equipment and other equipment (wafer transport and loading and unloading equipment, gas-handling equipment and clean room equipment, for example).

Source: Semiconductor Equipment Association of Japan

Table 2: Japan's Exports of Semiconductor Manufacturing Equipment

(in millions of yen*)

Actual

	FY 1986	FY 1987	FY 1988	FY 1989
Total	Y47,807	Y46,308	Y89,853	Y118,489
Design Equipment	0	0	0	0
Mask and Recticle Production Equipment	1,407	370	698	764
Wafer Production Equipment	253	188	483	801
Wafer Processing Equipment	22,005	26,421	55,217	73,120
Lithography Equipment	14,546	21,013	32,566	39,455
Etching Equipment	645	932	3,197	5,796
Sputtering and Deposition Equipment	4,835	2,659	5,091	7,825
Oxidation and Diffusion Equipment, Ion Implanters, Scrub/Spin/Bake Equipment, and Metrology Equipment	1,979	1,817	14,363	20,044
Assembly Equipment	4,235	5,046	11,851	13,686
Test and Inspection Equipment	19,141	14,145	21,137	28,187
Test Equipment	14,255	10,137	13,473	17,638
Probing, Handling and Other Equipment	4,886	4,008	7,664	10,549
Other Equipment	766	138	467	1,931

Projected**

	FY 1990	FY 1991	FY 1992	FY 1993
Total	Y129,850	Y148,440	Y166,600	Y182,660

*The following average annual exchange rates can be used to convert the yen figures into dollars: FY 1986, Y159.84; FY 1987, Y138.35; FY 1988, Y128.26; and FY 1989, Y142.83.
**September 1990 forecast by the Semiconductor Equipment Association of Japan.

Note: SEAJ uses a broader definition of semiconductor manufacturing equipment than market researchers and analysts in the United States. They exclude design equipment, mask and recticle production equipment, wafer production equipment and other equipment (wafer transport and loading and unloading equipment, gas-handling equipment and clean room equipment, for example).

Source: Semiconductor Equipment Association of Japan

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JEI REPORT

A Two-Part Report: A and B

NO. 21B
June 7, 1991

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Rush Job Tops Off Construction Talks

Last-minute arm-twisting by Prime Minister Toshiki Kaifu pushed Japanese negotiators June 1 to accept a compromise agreement that increases foreign access to Japan's public works market, thus averting American sanctions on Japanese contractors operating in the United States. The compromise will put 17 more projects under the umbrella of the 1988 Major Projects Agreement, doubling the number covered by the pact. In addition, the MPA was strengthened in several areas to address weaknesses that had surfaced during its implementation. Although the new agreement has been welcomed almost universally, it still may not satisfy the long-term goal of U.S. architects, engineers and contractors to obtain a significant share of Japan's huge construction market.

The White House had been pushing for a more open Japanese construction market for several years before successfully negotiating the MPA in May 1988. That agreement established special rules to help foreign firms gain experience with Japan's designated bidder system and provided 17 projects for which they

Riegle measure to the Senate floor for a vote. Yet in light of the strong margin of Senate support for the fast-track extension, Washington watchers are dubious that the measure could gain sufficient votes to survive in that chamber. The legislation is expected to be brought up in late June or early July and could be considered on its own or as an amendment to another bill, an aide to Sen. Riegle said.

U.S. Trade Representative Carla Hills is scheduled to meet with Mexican and Canadian trade officials in mid-June to agree on an action plan for the NAFTA talks. Bolstered by the Gephardt-Rostenkowski resolution and the possibilities presented by the Riegle proposal, Capitol Hill is likely to keep a careful watch on the upcoming negotiations.

Margo Grimm

Bankruptcies Continue Rising In Japan

From 1988 through much of 1990 tracking the direction of the Japanese economy was a snap. One could pick virtually any economic statistic and it would show the economy on a rapid upward path. The data on bankruptcies, for example, were particularly dramatic: business failures fell for 69 straight months through last October and 1990 showed a sharp overall decline from 1989, according to data released by the Teikoku Data Bank, Ltd. (see Table). Beginning in November, however, and continuing through at least April (the latest month for which data are available) this trend has reversed, with bankruptcies rising every month over year-earlier levels. April bankruptcies, for example, increased 59 percent, while the total liabilities of the covered companies soared 304.8 percent.

Bankruptcies in Japan, 1980-91*

		Cases	Total Liabilities (billions of yen)	Average Liabilities (millions of yen)
1980		17,884	Y2,707	Y151.4
1981		17,610	2,692	152.9
1982		17,122	2,355	137.5
1983		19,155	2,564	133.9
1984		20,841	3,626	174.0
1985		18,812	4,186	222.5
1986		17,476	3,752	214.7
1987		12,655	2,055	162.4
1988		10,123	2,059	203.4
1989		7,234	1,195	165.2
1990		6,468	1,944	300.6
1991	January	646	642	993.8
	February	676	329	486.7
	March	773	791	1,023.3
	April	835	855	1,024.0

*Included are bankruptcies of corporations and unincorporated enterprises.

Source: Teikoku Data Bank, Ltd.

The companies failing this year are of record size. In March and April liabilities of the average bankrupt company topped Y1 billion ($7.4 million at Y135=$1.00) for the first time. Nearly half the total for April came from two firms: Shizushin Lease Corp., with debts of Y256.2 billion ($1.9 billion), and Nippon Saiken Toshi K.K., which owed Y150 billion ($1.1 billion). Even if these two companies were to be omitted, the average failed company would have been significantly larger in April 1991 than a year earlier.

Failures in the construction and the real estate industries accounted for 46 percent of the surge in April bankruptcies. Firms in these two businesses appear to be caught between softening land prices and higher interest rates. A Teikoku Data Bank official said that the level of bankruptcies is likely to remain high or increase for the next six months even if the Bank of Japan, as widely expected, eases monetary policy and permits interest rates to fall.

BOJ or other officials are unlikely to lose any sleep on hearing the latest figures. Not only do a fair number of other economic indicators remain at least modestly bullish, the bankruptcy data have not proven particularly good indicators of the state of the economy in recent years. For example, the number of bankruptcies generally rose during the early 1980s despite average real economic growth of nearly 3.5 percent; the peak of 20,841 bankruptcies came in 1984. From 1985 to late 1990 the number consistently declined. Even when inflation-adjusted growth dipped in 1986 to 2.6 percent, the lowest rate since 1974, bankruptcies fell from the previous year's total. If the pace of the first four months is maintained for all of 1991, the number of bankruptcies will return to slightly more than the 1989 level but less than half the 1984 figure. Such a rate would imply that approximately one in every 300 Japanese firms will go bankrupt in 1991.

Rather than providing definitive information about the Japanese economy in general, the bankruptcy data are best seen as indicative of the financial dislocations that face an economy adjusting to higher interest rates. As such, they are part of a pattern that includes evidence of increasing problems at smaller Japanese financial institutions (see JEI Report No. 15B, April 19, 1991) and a few well-publicized bailouts of large companies that typically sank too many resources into risky real estate ventures. Few of these problems in the financial and the real estate industries have enough of a direct connection to the production of goods and services to make them more of a macroeconomic concern. The fact that bankruptcies arising out of labor shortages -- although still only 5 percent of all cases and 1 percent of total liabilities -- are on the upswing is a sign that the Japanese labor market remains tight. This, in turn, is important evidence that aggregate demand remains strong. The same figure also illustrates the conflicting signals that Japanese economic data are generating. For the next few months, at least, the economic tea leaf readers will earn their keep.

Douglas Ostrom

MITI To Restrict Trade Insurance Toward Soviet Union

The Ministry of International Trade and Industry's Export-Import Insurance Division reportedly has decided to tighten the criteria for providing

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REPORT

A Two-Part Report: A and B

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THE STRUCTURE OF JAPAN'S IMPORTS: CAUSES AND CONSEQUENCES

Summary

As Japan's still large external imbalances showed sharp declines in the late 1980s and last year, attention shifted toward the composition of Japan's trade. The opinion began to take hold among some analysts that simply selling more to Japan was not a sufficient goal if the products were relatively unsophisticated. This concern, which highlighted Japan's imports of manufactured goods, became politically more important. In addition, researchers who suspected that Japan's manufactured imports are unduly low started looking for reasons. Some of these experts pointed toward keiretsu (corporate groups) as a prime suspect. Other experts have disputed the finding that manufactured imports are unduly low and, thus, have questioned the alleged causes.

Keiretsu also are near the top of the agenda of the Structural Impediments Initiative, the U.S.-Japan dialogue that explores alleged structural deficiencies in each economy, particularly those that some officials see as contributing to the bilateral imbalance. Research concerning the level and the structure of Japan's manufactured imports appear to have influenced the SII talks by putting increased emphasis on keiretsu.

Public impressions to the contrary, the keiretsu debate -- and its discussion in the SII context -- have virtually nothing to do with the size of the trade imbalance between the United States and Japan. As U.S. trade officials admit, Japan's trade surplus with the United States is a result of the overall savings rates in both countries. At most, the questions surrounding keiretsu involve the composition of Japanese exports and imports. Recent data suggest that, on the import side at least, Japan's

trade structure continues to evolve in the direction advocated by American critics.

The Overall Context

Policymakers pay attention to U.S.-Japan trade for a number of reasons. The recent research by a variety of economists is relevant to some of these concerns but not others. Worry about the external imbalance between the United States and Japan typically focuses on the U.S. measure of the bilateral trade imbalance; this yardstick, however, involves a number of conceptual problems. (For descriptions of various measures and details of this argument, see JEI Report No. 15A, April 19, 1991.) Among other difficulties, the implied importance of a bilateral balance is misplaced. Even on the assumption that the equality of exports and imports is important, a worldwide balance in the accounts of both the United States and Japan would appear sufficient; this scenario, however, likely would mean Japan still would have a surplus with the United States. If the United States set itself the task of achieving a balance in trade with each of its partners with which it now runs a deficit, it probably would end up with a worldwide surplus and bruised feelings in dozens of capitals in the unlikely event of a successful effort.

Despite these problems, the U.S.-Japan trade imbalance has remained a focus. Since the 1970s the imbalance between the two nations has featured a consistent Japanese surplus, peaking at $52.1 billion in 1987, according to Ministry of Finance data. Japan's surplus with this country rose between 1985 and 1987 despite the appreciation of the yen against the dollar and did not dip below its 1985 level until 1990. The net reduction of 3.9 percent between 1985 and 1990 has seemed to many analysts a remarkably small return for years of investment in sometimes frantic trade negotiations and dramatic exchange rate adjustments.

The 1985-90 trend, however, appears to understate the improvement. Since U.S. exports to Japan in 1985 were slightly more than one-third the level of imports, closing the gap would have required exports to grow nearly three times as fast as imports. Furthermore, the yen's appreciation between 1985 and 1990 worked against any improvement to the extent that Japanese producers raised dollar-denominated prices to recover yen-based costs, thereby boosting the dollar value of Japan's outbound shipments. Seen in this context, the modest reduction in the dollar-denominated bilateral trade imbalance masked a substantial reversal of previous trends.

In the realm of trade negotiations, too, deficits are not necessarily a key motivator, even if negotiators sometimes act as if they believe otherwise. Consider the statement of Linn Williams, a deputy U.S. trade representative, to a congressional committee this spring:

> The issue for trade policy, however, is market access, not trade deficits. Trade deficits are caused primarily by macroeconomic factors, such as exchange rates and savings

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> rates. (Bilateral deficits are also unreliable indicators of trade policy, because they reflect only trade between two countries not among all countries.) For the trade deficit (overall or bilateral) to improve substantially, our savings rate must increase substantially.[1]

Mr. Williams' boss, Carla Hills, has made similar statments. For example, she responded to a question from Rep. Sam Gibbons (D, Fla.) on the cause of the U.S. trade imbalance by saying that macroeconomic factors have an "overwhelming influence on the health of our trading" and on the trade deficit.[2]

Either because they now agree that the bilateral imbalance is an inappropriate target or because they suspect its recent decline means that it is becoming less of a problem, those who call for a more activist trade policy vis-a-vis Japan appear to have realigned attention to the composition of U.S.-Japan trade. This view contends that, although Japan is importing more from the United States, the increased imports are the wrong products, at least from the U.S. perspective. Those who take this position frequently frame the U.S. economic output and export picture in terms of potato chips versus computer chips. (All but very young children, the densest economists and potato chip manufacturers are supposed to see the inherent advantages in producing computer chips, a low-profit, commodity-like product, rather than a brand-name, profitable product like potato chips.)

Kevin Kearns, formerly with the Department of State and now with the privately funded Economic Strategy Institute, appeared this spring before the same Senate subcommittee as Mr. Williams to repeat his call for a "Team B" to reevaluate U.S. economic policy toward Japan. (The expression "Team B" is borrowed from that of a group at the Central Intelligence Agency during the 1970s, when George Bush headed the agency; the group reassessed U.S. policy toward the Soviet Union.) After suggesting that broad statistical measures do not describe the full extent of the problem as he sees it, Mr. Kearns added,

> Yet even within the trade figures there are disturbing trends that administration officials apparently do not understand. At first glance, the new numbers [on U.S.-Japan trade] seem to indicate that Japan is opening its protected market and that American industry is meeting the Japanese challenge. But first glances are deceiving. The "how much" of the bilateral deficit no longer tells the whole story. Just as important is the composition of U.S.-Japan trade -- i.e. what is being traded and where in the global Japan production base it comes from.[3]

[1] Written statement of Linn Williams before Senate Governmental Affairs Committee, Subcommittee on Oversight of Government Management, May 8, 1991, p. 2.

[2] National Trade Policy Agenda: Hearings Before the Subcommittee on Trade of the Committee on Ways and Means, 101st Congress, 1st Session, February 28, 1989 (Washington, D.C.: Government Printing Office, 1989), p. 51.

[3] Written statement of Kevin L. Kearns before Senate Governmental Affairs Committee, Subcommittee on Oversight of Government Management, May 8, 1991, p. 6.

Does Japan Underimport?

The transfiguration of the "Japan problem" as encapsulated in Mr. Kearns' testimony has elements of an academic controversy that has simmered for years over Japan's trade structure. One description of this issue suggests that if Japan's import structure is out of whack, the cause is not excessive levels of so-called low value-added goods but an insufficient flow of high value-added products. Hence, this suggests that the potential problem is of Japan as an underimporter. Researchers have attempted to discover if Japan underimports and, if so, what policies or economic structures are responsible.

Traditional economic theory holds that, to achieve the highest economic status for itself, a country should export those products it is relatively good at producing and import those that it is relatively poor at making, provided that each can be traded easily. The theory adds that, if nations do not throw up roadblocks to such activities, profit-maximizing firms and consumers seeking the highest quality at the best price will induce this result automatically among countries with market economies. Hence, a nation that imposes high tariffs and/or quotas or otherwise restricts imports is doubly culpable, according to this theory: it denies the benefits of free trade not only to its own people and firms but to its trading partners as well. The effect of imposing barriers is to reduce the level of trade. Therefore, a nation with such restrictions can be considered an "underimporter."

Virtually no nation, including the United States, is totally innocent of erecting trade barriers. However, Japan's have attracted particular attention. For decades businessmen have complained about the difficulties of penetrating the Japanese market; a small library of books exists giving chapter and verse to their arguments. Measuring the net impact of those barriers is another, more difficult, matter. However, Gary Saxonhouse of the University of Michigan, in research efforts that span years, has come to a uniform conclusion: factor endowments, such as abundant labor or its absence, adequately explain trade patterns and there is no obvious need to include Japanese trade policies as a factor. As Mr. Saxonhouse puts it, ". . . [T]his suggests that whatever Japanese (and American) trade policies and/or informal barriers may have been, more than likely they have not been a major determinant of trade patterns."[4]

Mr. Saxonhouse's conclusion has not gone unchallenged, either in the academic community or elsewhere. Beyond the anecdotal evidence of Japanese barriers is the undeniable fact that Japanese imports of manufactured goods are low compared to other industrial countries.[5] While a casual observer might argue that Japan could be expected to import relatively little of what it obviously is extremely good at producing itself, many experts note that industrial nations typically import large quantities of goods only slightly different from those they themselves produce and sometimes export. The United States, for example, is both an exporter and an importer of manufactured food products; some Americans have a taste for exotic biscuits, for example, while some foreigners apparently have a craving for American fare. This kind of commerce, known as intra-industry trade, typically characterizes modern industrial economies.

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[4] Gary R. Saxonhouse, "Differentiated Products, Economies of Scale and Access to the Japanese Market," in Robert C. Feenstra (ed.), Trade Policies For International Competitiveness (Chicago, Illinois: National Bureau of Economic Research, 1989), p. 167.

[5] See JEI Report No. 14A, April 8, 1988, and Edward J. Lincoln, Japan's Unequal Trade (Washington, D.C.: Brookings Institution, 1990), pp. 39-60.

Because Japan imports comparatively few manufactured goods and presumably is not an overimporter of other goods, the intra-industry trade argument leads to the conclusion that Japan is an underimporter overall. While Mr. Saxonhouse's conclusion suggests that the low level of Japanese manufactured imports has explanations rooted in factor endowments (meaning, thereby, Japan is not an underimporter), Robert Lawrence of the Brookings Institution disagrees, at least to a degree. In a 1987 study he concluded:

> [I]n 1980, for example, as equations in this study indicate, unusual barriers and preferences reduced Japanese manufactured goods imports about 40 percent. The removal of such barriers would have increased the value of Japanese manufactured imports about $13 billion and lowered Japan's trade surplus in manufactured goods about $16 billion, or some 17 percent. Japan would have had considerably more intra-industry trade.[6]

In addition to Messrs. Lawrence and Saxonhouse, other researchers have taken a crack at the question in recent years, with differing results.[7] In addition, a number of experts have volunteered themselves as referees to this scholarly squabble. After quoting T.N. Srinivasan and Koichi Hamada of Yale University in their evaluation of the works by Messrs. Saxonhouse, Lawrence and others, Jagdish Bhagwati of Columbia University added his own observations and concluded, "The case that Japan's imports, whether total or of manufactures, are abnormally low, when set against predictions by international trade economists of what they should be, is thus seriously weak, and the best-crafted research militates against it."[8]

If Japan Underimports, What Factors Are Responsible?

The comments of Messrs. Srinivasan, Hamada and Bhagwati, while influential, have not silenced those who still believe that Japanese policies or practices are the cause of Japan's distinctive pattern of trade, particularly in manufactured imports. Mr. Lawrence, for one, is undeterred and, in fact, has built on his earlier work, which left open important questions of causality.

At least two explanations of low manufactured goods imports would indicate Japan has few options that it could pursue to increase their level. First, as Mr. Bhagwati and others have pointed out, if Japan is an underimporter, the cause could be the export restrictions that it faces.[9] This apparently outrageous statement deserves an explanation. In response to quotas or other restrictions on Japanese exports, the demand from abroad for yen would be lower than otherwise, causing the Japanese currency to depreciate; that, in turn, would make Japanese imports more expensive. The demand for imported manufactured goods could drop sharply in contrast to raw materials, whose demand is fairly unresponsive to price changes. Hence, export restrictions could lead fairly directly to low levels of manufactured imports in addition to lower-than-otherwise levels of manufactured exports.

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[6] Robert Z. Lawrence, "Imports in Japan: Closed Markets or Minds?" Brookings Papers on Economic Activity, 1987, No. 2, p. 546.

[7] For a summary of these efforts and some criticism of each, see Kenji Takeuchi, "Does Japan Import Less Than It Should? A Review of the Econometric Literature," Asian Economic Journal, III, September 1989, pp. 138-170.

[8] Jagdish Bhagwati, The World Trading System at Risk (Princeton, New Jersey: Princeton University Press, 1991), p. 37.

Second, a low volume of manufactured goods imports could be a result of more homogeneous tastes in Japan than in North America and Europe. As noted in the example of food products above, intra-industry trade arises in part because some consumers may prefer an imported version of a product that is made efficiently at home. If domestic tastes are homogeneous, local producers can turn out the desired product in large, efficient quantities, reducing the need for intra-industry trade in a good in which the country has comparative advantage.

Mr. Lawrence's research strategy has been to identify less benign alternative explanations of Japan's intra-industry trade and test for their significance. He finds a leading candidate in Japan's distinctive pattern of importation. In contrast to the leading role played by Japanese exporters in selling their goods in the American market, Japanese imports from the United States are likely to be handled by Japanese companies. This difference matters to Mr. Lawrence, who describes evidence that such firms mark up the prices charged in the Japanese market significantly more than their counterpart firms do in other markets. As Mr. Lawrence recently noted in testimony before a Senate subcommittee, "Foreign firms play a remarkably small role in selling their products in Japan, and the evidence below indicates they are paid only world market prices. Most of the unusually high prices for foreign products are due to Japanese distributors. Thus the beneficiaries of increased competition in the Japanese distribution system would be Japanese consumers and American exporters."[10] From this statement one easily concludes that, if Mr. Lawrence's research is correct, manufactured imports in Japan are low in part because they are overpriced by their (Japanese) importers.

Mr. Saxonhouse has challenged these arguments in a comment for a forthcoming book where an article by Mr. Lawrence also is to appear. Among other objections, the University of Michigan professor finds that the predominance of Japanese firms involved in imports stems largely from the fairly unimportant question as to where a firm takes title to an import (in the country of origin or of importation). In addition, he suggests that the high prices charged in Japan for American products could be the result of high-price, low-volume strategies developed by U.S. firms.[11]

[9] Ibid., pp. 36-39.

[10] Written statement of Robert Z. Lawrence before Senate Committee on Finance, Subcommittee on International Trade, April 15, 1991, p. 7.

[11] See Robert Z. Lawrence, "How Open is Japan," and Gary R. Saxonhouse, "How Open is Japan: Comment," in Paul Krugman (ed.), The U.S. and Japan: Trade and Investment (Chicago, Illinois: University of Chicago Press, forthcoming).

Mr. Lawrence recently has taken his argument yet another step, identifying Japan's low level of manufactured goods with another widely observed characteristic of the Japanese economy: *keiretsu*. (*Keiretsu* are described in JEI Report No. 2A, January 12, 1990.) His statistical tests appear to show that imports are particularly low in those sectors where *keiretsu*-related firms account for a comparatively large share of output, other factors equal. He finds, for example, that the effect of *keiretsu* in one of several equations he estimates -- absent exchange rate changes -- is to reduce the level of imports by more than 50 percent. Conversely, magically removing *keiretsu* would increase imports significantly, other factors equal, he suggests. As he acknowledges, however, the yen would depreciate in this situation, reducing the overall impact.[12]

Not surprisingly, Mr. Saxonhouse has challenged Mr. Lawrence's *keiretsu* study.[13] Many of his objections are related to the way in which Mr. Lawrence set up equations to relate the prevalence of *keiretsu* to import shares; taking account of many, if not all, of the problems Mr. Saxonhouse identifies would reduce the measured impact of *keiretsu* on import structure. Any downscaling of Mr. Lawrence's results would put his overall conclusion in serious jeopardy since the econometric confidence levels and the degree to which, even in total, Mr. Lawrence's equations explain import behavior are far from overwhelming. For example, the most successful of Mr. Lawrence's equations in explaining import shares explains only 45 percent of the variation among sectors even when *keiretsu* and eight other factors are included. This raises the real possibility that excluded factors may swamp the influence of the *keiretsu* component.

Another example of the fragility of Mr. Lawrence's results is the effect of the aircraft industry on his conclusions. Import shares are very large and the small domestic industry is dominated by *keiretsu*. In other words, this industry is an exception to the apparent relationship between *keiretsu* and imports. Mr. Lawrence chooses to exclude it from his equations but reports that, if the aircraft industry were included, the negative relationship between import shares and *keiretsu* would weaken significantly. In justifying the exclusion, he correctly notes that the industry is unusual in many ways. However, while some of the industry's unique characteristics arguably work to increase imports above predicted levels, other attributes could have the opposite effect. (For details concerning Japan's aircraft industry see JEI Report No. 34A, September 1, 1989). In short, since the case for excluding aircraft is not unambiguous, Mr. Lawrence's results are put in further jeopardy.

In summary, Mr. Lawrence's *keiretsu* study, like his earlier efforts, has its share of critics. In addition, the premise on which the *keiretsu* study is based -- that Japan is an underimporter -- is inconsistent with other important academic research. If, indeed, Japan is not an underimporter, then the keiretsu study loses much of its relevance.

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[12] Robert Z. Lawrence, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups," *Brookings Papers on Economic Activity*, 1991, No. 1, forthcoming. Mr. Lawrence summarized his argument in less technical language in the above-cited statement before Finance's trade subcommittee.

[13] Gary R. Saxonhouse, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups: Comments and Discussion," *Brookings Papers on Economic Activity*, 1991, No. 1, forthcoming.

Public Reaction and the Effect on SII

These caveats notwithstanding, Mr. Lawrence's work on keiretsu began attracting enormous attention in Washington and Tokyo even before its formal publication. For example, in an April *Washington Post* article deputy USTR Williams described Mr. Lawrence's work as "quite significant." David Hale, a widely quoted economist with Kemper Financial Services, said the results were "as close as you can get with these things to a smoking gun." Others, including two of Japan's best-known economists, were quoted as being critical.[14]

Coming as it did less than a month before the release of the first annual report on implementation of the pledges Tokyo and Washington made during the Structural Impediments Initiative discussions, in which Mr. Williams played a leading role, Mr. Lawrence's research -- and the subsequent publicity -- may well have had an impact on the May meeting to draft the assessment. In the context of SII, Washington would like Tokyo to put more emphasis on enforcing the Antimonopoly Law, adopting measures that would strengthen the law and monitoring keiretsu transactions more closely. While conceding that Japan has taken steps in these directions, the U.S. delegation's report added:

> Beyond these measures, the GOJ [government of Japan] has not appreciably furthered the agreed goals of the SII process in the keiretsu area. In particular, other measures to make keiretsu more open and transparent have been lacking. . . . The keiretsu system remains a formidable barrier to entry into the Japanese market.

The U.S. delegation also wrote that it had not seen evidence of increased monitoring by Japan's Fair Trade Commission of keiretsu transactions, another pledge that Washington felt Tokyo had made in the SII talks.[15]

Washington conceded, though, that Tokyo has taken some steps in recent months to prevent abuses of market power in Japan. If, as Washington charges, Tokyo is reluctant to do more, the reason could be that Japanese officials see limited anticompetitive effects arising out of keiretsu behavior and, perhaps, even some benefits in terms of increased efficiency.

Effect on U.S.-Japan Trade Flows

Despite considerable academic skepticism, Mr. Lawrence's work clearly has had an influence. Japanese policy -- with considerable U.S. prodding -- may move further in the direction that Mr. Lawrence's research seems to suggest would be desirable. If he is right that the effect of keiretsu is to impede imports, then many U.S. firms would find the Japanese market more attractive if whatever the keiretsu firms are doing to impede access could be minimized. In short, the effect would be similar to that of lowering a tariff. If so, would the U.S.-Japan trade imbalance improve? An indirect answer can be found in a Brookings article using data from the years 1981 to 1986, when Japan's surplus with the United States rose from $13.3 billion to $51.4 billion. In the article Mr. Lawrence and coauthor Robert Litan, also of Brookings, commented: "Although Japan continues to be singled out as having the most unfair trading practices of all U.S. trading partners, it is doubtful that such policies have been a major cause of the dramatic increase in Japan's trade surplus with the United States since 1981."[16]

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[14] Paul Blustein, "A New Study Fuels the Clash Over Keiretsu," *Washington Post*, April 26, 1991, p. F1.

[15] "Comments of the U.S. Delegation on the First Annual Report by the Japanese Delegation" in *First Annual Report of the U.S.-Japan Working Group on the Structural Impediments Initiative* (May 22, 1991), pp. 115-116.

This argument has an obvious corollary: if trading practices had relatively little to do with the rise of the bilateral imbalance, they have at most a limited role in reducing it. This conclusion meshes neatly with the earlier statement by USTR's Williams about the irrelevance of trade policy to the bilateral deficit.

It follows, then, that the questions of Japan as an underimporter or its recent variant, the effect of keiretsu on imports, boil down to the issue mentioned earlier: the composition of trade. Conceivably, if Mr. Lawrence is correct, reducing keiretsu influence could remove barriers to imports of manufactured products. The effect would be an increase in U.S. exports, presumably including sophisticated products. A secondary effect would be yen depreciation, which would offset part of the increase in U.S. exports and also lift American imports of Japanese goods. In short, the net effect would be an increase in trade in both directions, with an ambiguous impact on the bilateral imbalance. American consumers and businesses -- and quite likely their Japanese counterparts -- would be better off from being able to use the world's resources more efficiently. The stronger dollar would be the obvious manifestation of this development for the United States; Americans would have to give up less to obtain any given amount of imports. Exporters to the United States and elsewhere as well as purchasers of the products from which barriers are removed would be the most obvious beneficiaries in Japan.

Lower Japanese barriers leading to higher U.S. sales of manufactured goods also would create losers in the United States. The cheaper yen that would be one result of such changes would imply that those companies that compete with Japanese exports would have a harder time. For the same reason, those firms that already compete successfully in Japan probably would see their sales fall. As noted above, traditional economic theory would suggest that the American winners would outnumber the losers. This conclusion is even more likely if American manufacturers with substantial market power were newly able to extract high profits from the Japanese market. Finally, to the extent that the higher exports contained a substantial high technology component, American firms and consumers not directly affected still could benefit if technology development and diffusion proceeded more rapidly than otherwise.

[16] Robert Z. Lawrence and Robert E. Litan, "The Protectionist Prescription: Errors in Diagnosis and Cure," Brookings Papers on Economic Activity, 1987, No. 1, p. 294.

Recent evidence suggests that the composition of Japan's imports -- in particular those from the United States -- is moving toward a greater proportion of manufactured goods. As shown in Table 1, manufactured goods as a percentage of total imports more than doubled during the 1980s, climbing from 22.8 percent to 50.3 percent in both 1989 and 1990. Some economists like Rudiger Dornbusch of the Massachusetts Institute of Technology have argued that such figures mean little if manufactured imports as a share of gross national product are nonetheless constant or declining.[17] Although the ratio of manufactured to total imports started rising at the beginning of the decade, manufactured goods maintained a fairly constant share of GNP until a two-year low in 1986 and 1987. Since then, however, the ratio has risen sharply. In sum, manufactured imports had a significantly larger share of GNP in 1990 than they did in 1980 and double the 2 percent figure that Mr. Dornbusch suggested was virtually a historical constant.

Table 1: Japan's Manufactured Imports, 1980-90

(in millions of dollars, c.i.f value)

	Manufactured Imports	Change in Volume	Share of Total Imports	Share of GNP	U.S. Share of Manufactured Imports
1980	$32,110	-2.5%	22.8%	3.0%	33.5%
1981	34,778	12.5	24.3	3.0	33.0
1982	32,827	0.6	24.9	3.0	34.9
1983	34,361	2.5	27.2	2.9	36.0
1984	40,614	20.2	29.8	3.2	34.4
1985	40,157	1.8	31.0	3.0	35.5
1986	52,781	22.6	41.8	2.6	33.4
1987	65,961	12.5	44.1	2.7	26.8
1988	91,838	30.5	49.0	3.1	25.6
1989	106,111	12.3	50.3	3.7	26.5
1990	118,028	10.3	50.3	4.0*	27.5

*Preliminary

Source: Calculated from data provided by Ministry of Finance, Ministry of International Trade and Industry and Economic Planning Agency

Table 1 also shows that the position of the United States vis-a-vis other exporters of manufactured goods to Japan has undergone some erosion. The composition of Japanese purchases from the United States, however, has mirrored that of Japanese trade overall in showing manufactured products growing faster than total purchases (Table 2). The expansion of manufactured imports generally has outpaced the growth of other imports from the United States since at least 1980, resulting in an increased percentage of U.S. exports to Japan accounted for by manufactured goods.

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[17] See, for example, Rudiger Dornbusch, "Give Japan a Target and Say 'Import'," The New York Times, September 24, 1989.

Table 2: Japan's Imports from the United States, 1980-90*

	Rate of Change		Manufactured Imports as Share of Total
	All Imports	Manufactured Imports	
1980	19.5%	24.5%	44.0%
1981	3.6	6.7	45.3
1982	-4.4	-0.1	47.4
1983	1.9	7.9	50.2
1984	9.0	12.9	52.0
1985	-4.0	1.9	55.2
1986	12.6	23.9	60.7
1987	8.4	0.2	56.1
1988	33.5	33.2	56.0
1989	14.8	19.5	58.3
1990	8.5	15.5	62.0

*Imports in dollars, c.i.f. value.

Source: Ministry of Finance

Some analysts have made much of the fact that the bilateral imbalance in some manufactured goods has risen despite the decline in the overall imbalance.[18] Indeed, even the overall imbalance in manufactured goods has risen in recent years. This result is easily reconciled with the data in Table 2, however. Japanese exports of manufactured goods to the United States were, and are, much larger than the equivalent U.S. exports to Japan; in 1985, for example, the ratio was about 4.5 to 1, according to data from the Ministry of Finance. With this disparity in size the same rates of growth of each country's manufactured exports would result in an even larger absolute difference in the two figures; that is, Japan's surplus in manufactured goods would expand. To even retain the above imbalance U.S. exports would have to grow 4.5 times as fast as Japan's. While Japan-bound manufactured goods have increased far faster than comparable shipments from Japan, the disparity was not enough to prevent the bilateral imbalance in manufactured goods from widening between 1985 and 1990. By 1990, however, Japan's shipments of manufactures to the United States had dropped to 2.8 times the movement in the other direction. In short, the dollar value of the imbalance in manufactured goods rose between 1985 and 1990, but U.S. exports to Japan as a percentage of U.S. imports from Japan moved closer to balance, although, even in percentage terms, the imbalance remained extremely large.

Finally, Table 3 shows that Japan's manufactured imports increasingly are made up of products classified as sophisticated, although a definitive assessment is difficult since the categorization of a product as sophisticated is subjective. Such products as textiles and apparel, which often are regarded as embodying low technology, reduced their import share somewhat because of relatively slow growth. However, the share of machinery and transportation equipment, of which many types are widely thought to fall into the high technology category, grew substantially over the 1988-90 period.

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[18] See, for example, Kearns, op. cit., pp. 6-7.

Table 3: Composition of Japan's Imports of Manufactured Goods, 1987-90

	1987	1988	1989	1990
Chemicals	18.0%	16.1%	15.0%	13.6%
Organic Chemicals	5.3	5.0	4.4	3.8
Inorganic Chemicals	1.3	1.2	1.2	1.0
Dyes and Coatings	0.8	0.7	0.6	0.6
Pharmaceuticals	3.2	2.9	2.6	2.4
Perfumes and Flavoring Materials	0.2	0.2	0.2	0.2
Toilet Preparations and Detergents	0.4	0.4	0.4	0.4
Fertilizers	0.5	0.5	0.4	0.3
Explosives	0.1	0.0	0.0	0.0
Plastics	1.8	1.6	1.5	1.4
Mineral Tar and Crude Pharmaceuticals	0.7	0.6	0.8	0.6
Radioisotope Elements	1.7	1.3	1.2	1.1
Other Chemicals	2.0	1.8	1.7	1.7
Machinery and Transport Equipment	29.0	29.0	30.5	34.7
Nonelectric Machinery	10.2	10.2	10.8	11.8
Electric Machinery	9.3	10.1	10.8	10.9
Transportation Equipment	7.0	6.7	6.5	9.4
Precision Instruments	2.5	2.1	2.3	2.6
Textiles and Apparel	11.6	11.6	12.5	10.8
Metals and Fabricated Products	13.7	16.5	15.5	13.8
Steel	3.8	5.0	4.8	3.9
Nonferrous Metals	8.6	10.1	9.3	8.4
Fabricated Metal Products	1.3	1.4	1.4	1.5
Other Manufactures	19.7	19.9	21.0	22.0
Leather, Leather Products and Furs	0.4	0.3	0.3	0.3
Rubber Products	0.7	0.7	0.7	0.6
Wood Products	2.5	2.3	2.7	2.5
Paper and Paper Products	1.3	1.2	1.2	1.0
Nonmetallic Mineral Products	4.4	4.5	4.5	4.6
Miscellaneous Goods	10.4	11.0	11.6	13.0
Reimports and Commodities Not Classified by Kind	8.2	6.8	5.4	5.2
Total Manufactured Imports	100.0	100.0	100.0	100.0

Notes: Based on classification system used in White Paper on International Trade (Tokyo: Japan External Trade Organization, 1990), pp. 158-159.

Imports accounting for less than 0.05 percent of the 1989 total were reclassified from nonmetallic mineral products to textiles in 1990.

Source: Ministry of Finance

Pharmaceuticals, a high technology category by most accounts, declined in relative importance despite a 34.3 percent jump in dollar-denominated imports over the 1987-90 period. In this and a number of other product groups, the import figures do not fully reflect the success of foreign firms in Japan's markets to the extent that U.S. and other foreign companies receive substantial licensing fees from Japanese companies or produce their products in Japan.

Tables 1-3, along with the concurrent decline in Japan's trade surplus both overall and with the United States, present a remarkably consistent -- and encouraging -- picture for those concerned about the composition of Japan's trade. Import growth has outpaced export growth; manufactured imports have grown faster than purchases of industrial and agricultural inputs, and relatively sophisticated manufactured imports may well have grown fastest of all.

Implications of the Growth of Manufactures

Does the recent growth in imports of manufactured goods suggest that Mr. Lawrence's work on keiretsu is out-of-date before its formal publication? His estimates of the effect of keiretsu are based primarily on 1985 data, but they are not necessarily invalid for this reason. The keiretsu factor still may be an important influence, other factors equal. If other factors, such as the exchange rate, move up or down, the level of imports could change without affecting the power of the keiretsu factor. Robert Corker of the International Monetary Fund, however, has found evidence that the structure of Japanese imports, including manufactured goods, changed in the second half of the 1980s in ways not predictable from conventional equations. While Mr. Corker does not address the question of keiretsu, his results suggest that the influence of keiretsu on the import structure could have changed in recent years.[19] In addition, as Mr. Saxonhouse has pointed out, implementation of Tokyo's SII pledges concerning the distribution system could create more competitive markets in Japan, reducing the distortions keiretsu may or may not introduce.[20]

Rather than discovering the smoking gun in keiretsu and trade, Washington policymakers may have jumped the gun in bearing down hard on keiretsu as part of the SII process. Whether keiretsu are important or not, the data make clear that significant changes are under way in the level and, quite often, the structure of Japan's imports. U.S. suppliers, whose share of Japan's manufactured goods imports has dipped modestly in recent years, nonetheless have seen the absolute size of their Japanese market expand significantly.

[19] Robert Corker, The Changing Structure of Japanese Trade Flows (IMF Working Paper WP/90/107, November 1990).

[20] Saxonhouse (1991), op. cit.

For further information, contact Douglas Ostrom.

Patrick Trepanier provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JEI

REPORT

A Two-Part Report: A and B

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MITI White Paper Highlights Economic Blocs

The European Community's approach to substantial further economic integration in 1992 and steps taken by the United States, Canada and Mexico toward a North American Free Trade Agreement have drawn top billing in the Ministry of International Trade and Industry's 1991 white paper on international trade. The report, released May 31, notes that Japan is the only large industrial nation not currently involved in either the EC 1992 process or the envisaged NAFTA. To analyze this situation MITI borrowed from a classic economic framework.

As explained in 1950 by the economist Jacob Viner, trading blocs create both problems and opportunities. A major problem is that outsiders, presumably Japan in this instance, could lose export markets and sources of imports as

Japanese Research And Development Spending Expands Again

An annual government survey of Japanese outlays for research and development clearly shows that FY 1989 was another record-setting year from almost every perspective. Increases in total and component spending underscore Japan's strong international competitive position and the nation's commitment to building the world's preeminent knowledge-intensive economy. The comparatively modest increase in spending for basic research and development, however, remains a glaring weakness.

For its latest report the Management and Coordination Agency surveyed 12,500 businesses (all with capital of at least Y5 million or $37,000 at Y135=$1.00), 2,200 universities and other academic institutions, and 1,500 private research organizations. Responses indicated that total Japanese R&D expenditures rose 11.2 percent to Y11.8 trillion ($87.4 billion) during the year ended March 31, 1990 (see Table 1). The percentage gain was the highest since FY 1985 and pushed up the ratio of total R&D spending to gross national product to just over 2.9 percent; the previous fiscal year's figure was just under that mark. Although the agency cautions that international comparisons are difficult because of exchange rate fluctuations, different accounting periods and other factors, it nevertheless claims that Japan probably spent more on R&D in FY 1989 than any other nation except the United States. Japan, however, earmarks only a small portion of its total for defense technology, making it possible that Japanese spending on civilian R&D approaches or even surpasses that by the United States.

Table 1: Japan's R&D Expenditures, FY 1984-FY 1989

(in billions of yen and percent)

Fiscal Year	Companies	Research Institutions	Universities	Total
1984	Y5,136.6	Y1,033.1	Y1,724.2	Y7,893.9
Change	12.6%	6.4%	4.5%	9.9%
Share	65.1%	13.1%	21.8%	100.0%
1985	5,939.9	1,160.6	1,789.8	8,890.3
Change	15.6%	12.3%	3.8%	12.6%
Share	66.8%	13.1%	20.1%	100.0%
1986	6,120.2	1,240.2	1,832.6	9,192.9
Change	3.0%	6.9%	2.4%	3.4%
Share	66.6%	13.5%	19.9%	100.0%
1987	6,494.3	1,384.5	1,957.9	9,836.6
Change	6.1%	11.6%	6.8%	7.0%
Share	66.0%	14.1%	19.9%	100.0%
1988	7,219.3	1,394.2	2,014.1	10,627.6
Change	11.2%	0.7%	2.9%	8.0%
Share	67.9%	13.1%	19.0%	100.0%
1989 (p)	8,200.0	1,500.0	2,100.0	11,800.0
Change	13.8%	7.1%	5.0%	11.2%
Share	69.5%	12.7%	17.8%	100.0%

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

When analyzed by spending organization, the data show private companies continued to lead the way in FY 1989; their Y8.2 trillion ($60.7 billion) in expenditures was 13.8 percent more than the year before and came to 69.5 percent of total research outlays, compared with 67.9 percent in FY 1988. Academic laboratories' R&D budgets allowed 5 percent greater outlays, or Y2.1 trillion ($15.5 billion), and research institutions boosted spending by 7.1 percent to Y1.5 trillion ($11.1 billion). Both accounted for a smaller share of total spending than last year because these increases were significantly less than that recorded by private businesses; universities' share dropped from 19 percent to 17.8 percent and research institutions' share fell from 13.1 percent to 12.7 percent.

Not surprisingly, the private sector not only spent the largest amount on R&D but also provided the vast majority of funding in FY 1989. Businesses directed Y9.6 trillion ($71.1 billion) to their research laboratories, a 12.9 percent increase over FY 1988. This put their share of total R&D funds at 81.3 percent, the first gain since FY 1985. The government share of total R&D funding correspondingly declined from 19.9 percent in FY 1988 to 18.6 percent in FY 1989, even though it rose in absolute terms from Y2.1 trillion to Y2.2 trillion ($15.6 billion to $16.3 billion).

Spending broken down by purpose shows that commercialization of technology remains the top priority (see Table 2). Of the Y10.8 trillion ($80 billion) spent on hard sciences (excluding the social sciences and humanities), 63.2 percent was classified as "developmental," 23.9 percent as "applied" and 12.8 percent as "basic." These percentages mainly were unchanged from the previous year, although uneven spending gains were reported for each category (13.4 percent for development, 10.3 percent for applied and 8 percent for basic). The heavy commercial emphasis of Japanese R&D spending is highlighted by data

Table 2: Japan's Natural Science Research Expenditures by Purpose, FY 1984-FY 1989

(in billions of yen and percentage share)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1984	Y959.9	Y1,780.8	Y4,340.2
	13.6%	25.1%	61.3%
1985	1,030.6	2,001.8	4,985.9
	12.9%	25.0%	62.2%
1986	1,102.8	2,030.8	5,185.0
	13.3%	24.4%	62.3%
1987	1,250.2	2,166.8	5,497.3
	14.0%	24.3%	61.7%
1988	1,288.0	2,346.6	6,041.0
	13.3%	24.3%	62.4%
1989 (p)	1,390.9	2,588.4	6,848.0
	12.8%	23.9%	63.2%

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

showing that the average Japanese company devoted 2.7 percent of its total sales to R&D and that manufacturers had an even higher average of 3.3 percent.

Turning to trade in technology, the survey reported that for the first time since statistics have been collected, the value of Japan's technology exports nearly equalled the value of its imports of foreign know-how, as measured by the amount of licensing fees and royalties received and paid, respectively. Japanese firms spent Y329.9 billion ($2.4 billion) in FY 1989 to license foreign technology, a 6 percent increase over the previous period. Royalties received from abroad, however, rose by a whopping 34 percent to Y329.3 billion ($2.4 billion). The preliminary results released by the Management and Coordination Agency do not indicate the source of the increase.

Jon Choy

Trade Insurance Panel Eyes Debt-Reduction Plans

The debt-reduction plans being worked out by Tokyo and Western capitals for troubled international borrowers will require more budgetary help for the trade insurance program run by the Ministry of International Trade and Industry, the ministry's trade insurance advisory group warned in a June 10 report. In April Japan and other members of the so-called Paris Club of creditor nations agreed to a 50 percent reduction in Poland's government-to-government debt and private loans backed by official trade insurance; a similar arrangement was put together for Egypt the following month. Creditor governments have a choice of forgiving outstanding principal, reducing interest payments or some combination of these options.

Since the Ministry of Finance has philosophical problems with debt forgiveness, particularly for middle-income countries like Poland (see JEI Report No. 16B, April 26, 1991), MITI's trade insurance panel recommended that the interest rates on the commercial loans covered by the Polish and the Egyptian debt-relief arrangements be cut from market levels to concessional rates to help achieve the 50 percent reduction. The ministry's trade insurance program currently backs a total of about Y300 billion ($2.2 billion at Y135=$1.00) in commercial loans to Poland and Egypt. If the Japanese exporters and banks that extended these loans were to seek compensation for business losses caused by cut interest rates, the trade insurance fund eventually would have to pay out Y150 billion ($1.1 billion). That would be a major blow to MITI's plans to get the trade insurance fund, which had a deficit of Y369.8 billion ($2.7 billion) at the end of March, back into the black.

Since the worldwide debt crisis began deepening in 1982, MITI has tried to help struggling Third World borrowers by allowing them to extend the repayment schedules for commercial loans backed by trade insurance (see JEI Report No. 14A, April 12, 1991). It covered trade bills up to the insurance ceiling in exchange for borrowers agreeing to repay MITI what they owed originally plus additional interest that varied depending on the length of the extension. The ministry, in turn, borrowed from the government's Fiscal Investment and Loan Program, or capital budget, at commercial rates to bridge the temporary shortfall in the trade insurance account on the understanding that this money eventually would be repaid; obviously, the success of this plan depended on borrowers living up to the terms of their rescheduling agreements.

So far, MITI has covered more than Y1.7 trillion ($12.6 billion) worth of rescheduled payments in agreements with 32 countries. Of this total, almost half has been repaid to MITI in accordance with the arrangements worked out for extended repayment. MITI still expects to be able to balance the trade insurance fund over this decade. Therefore, it continues to provide trade insurance to back newly committed credits for selected countries with debt-rescheduling programs.

The presently envisioned means for implementing the debt-reduction arrangements for Poland and Egypt, however, would make it hard if not impossible for MITI to eliminate the deficit in the trade insurance account in the foreseeable future. There also are concerns that other heavily indebted countries, such as the Philippines and Peru, will press Japan for the same treatment given Poland and Egypt; Tokyo, however, considers these latter cases to be exceptional. Moreover, sub-Saharan countries and other countries with low national incomes, which had their outstanding debt reduced by one-third in 1988, now are suggesting that they should qualify for additional debt relief since they are at more of an economic disadvantage than Poland and Egypt.

Given the trade insurance account's problems and prospects, the MITI advisory panel urged the government to consider compensating the fund for losses attributable to the Polish and Egyptian debt-relief plans from money earmarked in the general account budget for official development assistance. Funding for foreign aid is one of the few budget categories that has increased at a rate far higher than the overall ceiling on discretionary spending in recent years, thereby allowing room for this proposal to be implemented. MITI plans to include the panel's recommendation in its FY 1992 budget request, which will be compiled in August. If the ministry gets its way, it will start writing trade insurance on new commercial loans to Poland and Egypt; new lending to these countries has been suspended since the spring.

Tadashi Saito

Nakayama Visit Hints At Improved Japan-Israel Ties

Foreign Minister Taro Nakayama's May 30-June 1 visit to Jerusalem contained hints of a possible expansion of political and commercial ties between Japan and Israel. Corporate Japan's observance of the Arab economic boycott of Israel seems to be easing slightly. There also are indications that Tokyo will be increasingly attentive to relations with Israel. Steady pressure from Washington in recent years as well as the impact of the Persian Gulf War appear to be factors in the gradually changing Japanese stance.

Mr. Nakayama, who traveled to Israel on a Middle East tour that also included Iran and Egypt, told leaders in Jerusalem that Japan is interested in playing a more active role in the region. During a meeting with his Israeli counterpart David Levy, the Japanese foreign minister expressed Tokyo's support for a regional peace conference proposed by the United States and cited United Nations resolutions calling for an Israeli withdrawal from land annexed in the 1967 Arab-Israeli War. Mr. Nakayama asked that Israel make a "reasonable and flexible" response to the U.S. proposal, but Mr. Levy countered that such a conference would be contingent on Syria's stance. Mr. Nakayama further promoted U.S. goals for peace talks by asking for better treatment of Palestinians living in the West Bank and the Gaza Strip plus an end to construction of settlements for Jewish residents in these occupied lands. Mr. Levy responded, however, that Israel has agreed with Washington on a two-phase plan to resolve the Palestinian issue and would not make further concessions.

Addressing Japan's stated interest in playing a larger role in the region, Prime Minister Yitzhak Shamir proposed that Tokyo help fund the resettlement of Palestinian refugees in occupied territories. Prior to a tour of a West Bank refugee camp and a meeting with Palestinian leaders, Mr. Nakayama, in fact, promised that Japan would extend greater economic and political assistance for the Palestinians through international organizations. That pledge came in a speech at the opening of a Japan-funded community center for Palestinians.

The Arab boycott issue also was raised during the foreign ministers' meeting. In response to Mr. Levy's request for assistance in breaking the decades-old ban -- under which certain Arab nations reportedly refuse to do business with companies that deal with Israel -- Mr. Nakayama characterized the boycott as undesirable and an impediment to international trade. While the United States, Canada and some Western European nations prohibit companies from adhering to the boycott, Japan officially takes a hands-off approach. Tokyo has said that observance of the boycott is a matter for the private sector to decide based on commercial considerations. In general, Japanese companies have been careful to keep open opportunities for trading with Arab countries; as a result, Japan has been characterized as being more stringent about the boycott than any other non-Arab country. The Israeli government has noted that it receives frequent complaints about Japanese companies that will not sell to Israeli buyers. An April report by the New York-based World Jewish Congress described Japan as "the country whose indiscriminate, government-encouraged compliance with the Arab boycott surpasses that of any other industrialized state."

Such criticism is not new, but soon after the report was released several Japanese companies named as refusing to deal directly with Israel announced plans to change their trade practices. Toyota Motor Corp. said it would begin exporting 5,000 cars a year to Israel this fall; Nissan Motor Co., Ltd. and Mazda Motor Corp. later announced similar plans. The three motor vehicle manufacturers said commercial considerations drove their decisions. Yet analysts suggest that Japanese firms may be reassessing their stance toward Israel due to perceived political shifts in the region following the Persian Gulf War as well as concern that their continued reluctance to deal with Israel may lead to a boycott of Japanese products in the United States. The head of the World Jewish Congress greeted the announcement that Nissan would start exports to Israel as an "important signal that Japan's policy toward Israel is changing," adding that it would help Japan's image in the United States.

Japanese firms with links to Israel also were criticized for the speed with which they cut those ties during the Persian Gulf War; commercial and financial exchanges between the two countries plummeted, and even postal service briefly was blocked during the war. Bilateral trade returned to previous levels soon after the ceasefire, however. Although slight compared to trade between Japan and the oil-rich gulf nations, Japan-Israel dealings have grown consistently in recent years (see Table). Such firms as Mitsubishi Motors Corp., Honda Motor Co., Ltd. and Fuji Heavy Industries, Ltd. long have traded with Israel. Tokyo's reported plans to add a Ministry of International Trade and Industry representative to its embassy in Israel may foreshadow stronger trade ties.

Japan's Trade with Israel, 1985-90

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1985	1986	1987	1988	1989	1990
Exports	$170.4	$274.9	$346.0	$420.4	$317.5	$509.0
Imports	214.9	322.4	481.2	684.5	757.9	879.4
Balance	-44.5	-47.5	-135.1	-264.0	-440.3	-370.4

Source: Japan Tariff Association

Analysts and business leaders disagree over how readily most Japanese firms will redirect their Middle East trade efforts to include Israel. For its part, Washington has sent clear signals that it would like to see improved Japan-Israel ties. In April President Bush told Prime Minister Toshiki Kaifu that the conclusion of the Persian Gulf War "might be an opportunity for Japan to have closer relations with Israel." Vice President Dan Quayle underscored this suggestion during his May visit to Japan. Washington has prompted Tokyo to strengthen relations with Israel through economic assistance as well as increased business ties. During his recent visit Mr. Nakayama said that, at Israel's request, Japan is prepared to extend unprecedented help through letters of credit from the Export-Import Bank, one of the most common channels for Japanese aid to more developed countries.

Margo Grimm

Tokyo Opposes Moscow's Full Participation At G-7 Meeting

The Japanese government recently objected to the Soviet Union's participation in the upcoming London meeting of the leaders of the seven major industrial democracies on the grounds that "it would not be productive." Some summiteers had sought to include Soviet President Mikhail Gorbachev in the discussions. In their view his inclusion not only would recognize the advances the Soviet Union has made politically but would allow Mr. Gorbachev an opportunity to plead his case for more Western economic assistance to bolster his troubled domestic reform program. Tokyo, however, has insisted that Moscow implement economic reforms before receiving major outside financial assistance. Due to the Japanese government's objections and the concerns of other summit participants, including President Bush, Mr. Gorbachev instead will meet with the leaders of the United States, Great Britain, France, Italy, Germany, Canada and Japan for two days as a guest immediately following the formal discussions. "It is not going to be the G-8. It will still be the G-7," a government official of this year's host, Great Britain, was quoted as saying.

In what may be a repeat of last summer's Group of Seven meeting in Houston, Texas, Japan appears likely to take a hard line on the question of aid to the Soviet Union (see JEI Report No. 28B, July 20, 1990). Tokyo's resistance is rooted in its policy of delaying the increased economic assistance sought by Moscow until a long-standing dispute is resolved between the two countries concerning the Soviet Union's occupation of four islands northeast of Hokkaido --

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REPORT

A Two-Part Report: A and B

NO. 23A June 21, 1991

JAPAN'S ENERGY POLICY IN THE '90S

Summary

After being pushed from the top of the national agenda by several years of robust economic growth and moderate international crude oil prices, energy policy edged back to center stage in the aftermath of Iraq's invasion of Kuwait. Armed with emergency measures previously employed during the twin oil shocks of the 1970s, policymakers were able to cushion the impact of the Persian Gulf situation on the economy. Notwithstanding this achievement, Tokyo is refocusing attention on energy conservation and development of alternative energy sources, especially nuclear power. In contrast to the 1970s and 1980s, however, the domestic political and social environment is less friendly to conservation as well as atomic energy, although Tokyo is making more of an effort to influence international energy issues.

Current Energy Picture

Japan's continuing economic expansion kept energy consumption on an upward path in FY 1990, which ended March 31, 1991, according to Ministry of International Trade and Industry figures (see Table 1). Of key importance was the growth in energy consumed by the household and the transportation sectors, which once again outpaced the growth of industrial energy use. Seeking a better standard of living, Japanese consumers have been buying bigger and more appliances, as well as driving larger cars and flying overseas. This trend not only reinforces the government's claim that domestic demand has become a central pillar of economic growth but adds as well to baseline demand for energy. Increased energy demand, in fact, has pushed energy consumption ahead at a faster rate than overall economic growth. If government projections are correct, the Japanese economy suffered a second straight year of reduced energy efficiency in FY 1990, measured by dividing total economic output by total energy consumption (Table 2).

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As for the supply of energy (Table 3), oil's share of the total supply dropped in FY 1990 to 54.8 percent from the year earlier figure of 57.5 percent, itself up 0.3 percentage point. The FY 1990 decline in oil's dominance probably was due to conservation measures taken after Japan and Western allied nations embargoed oil exports from Iraq and Iraqi-occupied Kuwait in August 1990. In absolute terms, however, crude oil consumption continued its steady

Table 1: Japan's Energy Consumption by Sector

(in millions of kiloliters of crude oil equivalent;
percent change in parentheses)

Sector	FY 1987	FY 1988	FY 1989	FY 1990*
Industry	163 (4.9%)	173 (5.9%)	180 (4.0%)	188 (4.4%)
Households	76 (5.2%)	80 (5.3%)	85 (6.3%)	90 (5.9%)
Transportation	69 (4.1%)	72 (4.3%)	76 (5.5%)	81 (6.6%)
Total	308 (4.8%)	325 (5.5%)	341 (5.1%)	359 (5.3%)

*Partially estimated.

Source: Ministry of International Trade and Industry

Table 2: Japan's GNP and Energy Consumption

	FY 1987	FY 1988	FY 1989	FY 1990*
Gross National Product**	Y349,769.8	Y370,311.5	Y388,200.2	Y408,386.6
Change	4.9%	5.9%	4.8%	5.2%
Energy Consumption (kl)***	308	325	341	359
Change	4.8%	5.5%	5.1%	5.3%
GNP per Kiloliter****	Y1,135,616.2	Y1,139,420.0	Y1,138,417.0	Y1,137,567.1

*Projected.
**GNP in billions of yen at 1985 prices.
***Energy consumption in millions of kiloliters of crude oil equivalent.
****GNP per kiloliter of crude oil equivalent in yen.

Source: Ministry of International Trade and Industry

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Table 3: Japan's Energy Supply by Source

(in millions of units)

	FY 1989			FY 1990*			
	Actual	Crude Oil Equivalent	Share	Actual	Crude Oil Equivalent	Share	Percent Change
Oil (kl)	291.8	291.8	57.5%	292.5	292.5	54.8%	0.2%
Coal (mt)	121.3	92.4	18.2	139.2	106.1	19.9	14.8
Nuclear (kw)	79.2	49.7	9.8	81.6	51.2	9.6	3.0
Natural Gas (kl)	46.2	46.2	9.1	54.4	54.4	10.2	17.7
Hydroelectric (kw)	33.1	20.8	4.1	34.9	21.9	4.1	5.4
Alternatives (kl)	6.6	6.6	1.3	7.5	7.5	1.4	13.6
Total		507.5	100.0		533.4	100.0	5.1

*Partially estimated.

Source: Ministry of International Trade and Industry

climb, indicating how entrenched this source of energy is in the Japanese economy. Nevertheless, fears that the Persian Gulf crisis might cause oil shortages appeared to be behind the greater use of coal (up 14.8 percent) and natural gas (up 17.7 percent); the former went mainly for electricity generation and the latter for heating. After years of gradual expansion, nuclear power's share of the total energy supply slipped back to the level of fiscal 1988, despite a slight increase in the amount of power generated. Alternative energy sources provided a bright spot in a diversified supply picture by gaining some increase in share but showing strong growth in output.

The jump in imports of crude oil in 1990 (Table 4) highlights the efforts of domestic oil companies to negotiate the impact of the embargo on Iraqi

Table 4: Japan's Crude Oil Imports, Production and Inventories

(in 1,000 kiloliters)

	Production	Imports	Throughput	Rate of Operation	Ending Inventories
1980	505	256,833	232,452	67.3%	37,841
1981	456	230,239	210,072	60.9	35,978
1982	467	214,685	194,844	56.5	32,737
1983	492	207,794	187,780	56.9	29,550
1984	476	214,602	194,111	67.1	26,058
1985	625	198,330	179,805	62.3	25,483
1986	736	194,515	172,071	60.6	27,888
1987	707	185,380	167,389	60.7	26,953
1988	689	193,851	172,392	64.4	22,838
1989	641	209,691	182,703	69.2	23,364
1990	632	228,760	199,431	75.5	23,183

Source: Petroleum Association of Japan

and Kuwaiti oil. The 9.1 percent boost in crude imports put the annual import figure at its highest point in nearly a decade. Besides securing alternative sources of crude, domestic producers were able to lift output by turning to private and government strategic reserves to meet rising oil demand. The increased refinery throughput and rate of operation are clear responses to the Persian Gulf crisis.

Imports of petroleum products and nonoil energy sources showed mixed results in FY 1990 (Tables 5 and 6), with coal, heavy fuel oil, liquefied petroleum gas and liquefied natural gas imports rising and gasoline, kerosene and naphtha imports declining. Kuwait, Saudi Arabia and other Middle Eastern countries have been moving downstream into refined products. Partially in response to this but mainly because of pressure from the United States and Europe, Tokyo liberalized imports of refined products in 1986. It also has been trying to get domestic refiners to cut capacity. The plunge in imports of gasoline (35.5 percent), kerosene (33.4 percent) and naphtha (8.9 percent) was a direct result of the Persian Gulf conflict's impact on Middle Eastern refineries.

Table 5: Japan's Imports of Gasoline and Kerosene

(in 1,000 kiloliters and percent change over previous year)

	Gasoline		Kerosene	
	Amount	Change	Amount	Change
1985	0	--	0	--
1986	3,293	--	2,648	--
1987	4,190	27.2%	6,012	127.0%
1988	3,902	-6.9	7,472	24.3
1989	3,934	0.8	8,170	9.3
1990	2,537	-35.5	5,434	-33.5

Source: Petroleum Association of Japan

The upswing in imports of heavy fuel oil in 1990 conveyed another disappointment for energy planners. Tokyo, which has been urging industry to shift to cleaner, more efficient fuels for some time, was shocked by the jump in imports of heavy fuel oil in 1987 and again in 1990. Energy planners are hoping that 1990's record imports are a fluke caused by the gulf conflict and an unusually hot summer that forced utilities to reopen oil-fired generators. These same two factors probably boosted imports of coal as well. The domestic petrochemical industry was concerned over the gulf conflict's effect on supplies of naphtha, a basic feedstock, but domestic refiners were able to increase their output or find alternative sources.

Not at all surprising was the jump in the average cost of a barrel of oil between 1989 and 1990. After bottoming out in 1988 at $15.60 a barrel or Y12,550 per 1,000 kiloliters, oil prices moved up moderately in 1989 and then sharply in 1990. In an unfortunate confluence for Japanese importers, the yen depreciated against the dollar in 1989 and 1990, exacerbating the reflected yen cost of products that are denominated in dollars on global markets, such as crude oil (Table 7). The dollar cost of a barrel of crude rose 33.4 percent in

Table 6: Japan's Noncrude Oil Energy Imports

(in thousands of units)

	Coal (mt)	Naphtha (kl)	Heavy Fuel Oil (kl)	LPG (mt)	LNG (mt)
1980	68,570	7,363	7,431	9,725	16,324
1981	77,959	7,241	7,404	10,097	16,833
1982	78,535	8,998	6,893	11,861	17,480
1983	75,124	13,096	7,285	10,860	18,748
1984	87,227	13,414	7,342	11,320	25,738
1985	93,448	14,896	7,493	11,540	27,556
1986	90,392	17,294	6,924	11,942	28,261
1987	90,915	20,043	8,010	12,612	29,167
1988	101,243	22,634	7,993	12,690	30,765
1989	101,509	23,676	8,056	14,039	33,202
1990	103,550	21,573	8,951	14,723	35,627

Source: Ministry of International Trade and Industry

Table 7: Price (c.i.f.) of Imported Crude Oil

	Volume (1,000 kl)	Value ($ millions)	Dollars per Bbl	Yen per Kiloliter	Exchange Rate*
1980	254,428	$52,749	$32.97	Y47,197	Y236.14
1981	227,444	53,343	37.29	51,387	219.10
1982	212,235	46,266	34.66	53,906	247.28
1983	207,004	40,063	30.77	45,923	237.28
1984	208,908	39,379	29.36	43,713	236.66
1985	195,945	34,600	28.07	42,374	239.97
1986	188,838	19,502	16.42	18,189	176.12
1987	184,713	20,593	17.79	16,328	145.89
1988	192,166	18,852	15.60	12,550	127.93
1989	204,914	21,539	16.71	14,453	137.47
1990	225,251	31,584	22.29	19,842	141.51

*Yen per dollar; crude oil contract rate.

Source: Ministry of Finance

1990, while the price of a kiloliter in yen rose 37.3 percent. Prices for refined products (Tables 8 and 9) clearly showed the shock waves from Iraq's invasion of Kuwait, at both the wholesale and the retail levels. Wholesale and consumer prices generally moved in step with each other, although the latter showed a wider range of swings than the former. The change in the wholesale price of gasoline, for example, peaked at 11.9 percent (November's price compared to that in August when Iraq took over Kuwait), while gas prices at the consumer level rose 13.3 percent over the same period. Kerosene showed even broader fluctuations, jumping 60.1 percent at its peak retail price in October

Table 8: Wholesale Petroleum Product Price Indices

		Gasoline	Naphtha	Jet Fuel	Kerosene	LPG	Fuel Oil C
				(1980=100)			
1980		100.0	100.0	100.0	100.0	100.0	100.0
1981		106.2	99.7	108.6	114.4	112.8	118.0
1982		114.1	101.4	121.7	131.2	129.6	124.1
1983		111.1	91.9	123.3	125.0	123.1	116.3
1984		108.6	81.1	122.0	121.2	119.4	101.8
1985		106.3	79.2	122.7	115.3	113.4	106.9
1986		94.2	45.6	98.5	86.1	83.6	72.8
				(1985=100)			
1985		100.0	100.0	100.0	100.0	100.0	100.0
1986		88.6	57.6	80.3	74.7	73.7	68.0
1987		82.0	41.1	66.4	62.3	61.2	38.5
1988		79.4	36.3	63.5	54.4	53.0	40.7
1989		83.3	38.2	65.6	60.9	59.3	39.4
1990		87.7	45.7	75.5	75.5	73.6	47.7
1990:	I	85.1	41.1	71.4	67.8	66.1	46.7
	II	85.1	45.4	72.6	69.2	67.4	47.7
	III	85.6	47.5	71.8	72.9	71.0	47.7
	IV	94.2	48.6	86.3	92.1	89.9	48.6
1991:	I	88.1	65.4	80.2	76.8	74.8	60.8

Source: Bank of Japan

Table 9: Consumer Prices for Petroleum Products

		National Price Index (1985=100)			Tokyo Retail Prices		
		Gasoline	Kerosene	Propane	Gasoline (1 liter)	Kerosene (18 liters)	Propane (cu. m.)
1980		85.6	107.4	94.9	Y155	Y1,543	Y4,881
1981		108.3	113.6	98.4	157	1,628	5,079
1982		118.1	125.9	98.6	172	1,791	5,104
1983		109.0	118.6	99.2	156	1,718	5,134
1984		103.4	109.1	99.7	150	1,613	5,131
1985		100.0	100.0	100.0	146	1,494	5,104
1986		88.0	82.6	97.0	128	1,246	4,974
1987		85.3	61.5	91.5	126	918	4,747
1988		81.6	53.5	89.0	122	842	4,590
1989		84.1	52.5	89.5	122	838	4,584
1990		88.5	66.1	94.1	142	1,284	5,316
1990:	I	85.4	59.1	90.4	127	910	4,596
	II	89.5	60.6	91.8	128	922	4,664
	III	86.1	61.3	94.2	128	925	4,722
	IV	96.3	89.5	99.8	141	1,237	5,134
1991:	I	94.5*	81.0*	103.5*	136	1,205	1,775

*January-February 1991 only.

Source: Management and Coordination Agency but up only 36.6 percent at its highest wholesale price for the period. This discrepancy occurred despite close monitoring of energy prices by the Ministry of International Trade and Industry as well as other government agencies and warnings against price gouging (see JEI Report No. 43B, November 9, 1990).

With the economy continuing its second-longest postwar expansion in 1990 electricity output and consumption (Tables 10 and 11) grew as a natural consequence. Thermal sources, mainly oil- and coal-fired generators, maintained their share of total generated output at over 61 percent in 1990 for the second consecutive year. Nuclear power got back on track last year, generating a record amount of electricity despite the unexpected shutdown of two reactors (more

Table 10: Output of Electric Utilities in Japan

(in billions of kilowatt-hours)

	Total	Thermal	Nuclear	Hydro
1980	514.05	346.90	82.01	85.15
1981	523.14	352.18	87.23	83.74
1982	522.48	343.30	101.84	77.34
1983	555.49	360.98	113.12	81.39
1984	582.21	378.32	133.23	70.65
1985	603.93	363.75	158.98	81.19
1986	601.51	354.65	167.31	79.55
1987	640.16	378.99	186.61	74.57
1988	666.77	399.46	177.62	88.62
1989	704.68	431.16	181.86	90.54
1990	745.13	460.62	194.57	88.59

Source: Ministry of International Trade and Industry

Table 11: Japan's Electricity Consumption

(in billions of kilowatt-hours)

			Power				
				Manufacturing			
	Total	Light	Total	Total	Chemicals	Steel	Rail-roads
1980	464.25	105.27	353.98	190.77	26.79	61.80	12.71
1981	470.56	110.30	360.27	184.29	26.28	58.49	12.86
1982	471.44	112.79	358.65	177.95	29.22	53.69	13.06
1983	499.78	122.22	377.57	182.62	27.55	55.47	13.33
1984	524.53	127.51	397.02	191.97	28.76	57.04	13.13
1985	541.39	133.30	408.09	193.75	28.23	55.88	13.44
1986	537.74	136.52	401.22	182.05	25.61	50.01	13.62
1987	570.64	146.11	424.53	189.41	26.55	51.63	14.15
1988	597.41	153.08	444.33	203.83	26.18	54.69	14.77
1989	632.31	163.42	468.89	217.27	27.74	56.87	18.10
1990	667.44	174.15	493.28	206.62	28.24	57.87	16.18

Source: Ministry of International Trade and Industry

on this subject below). The unsteady performance of hydroelectric power reflects its dependence on the vagaries of precipitation. (Note that these figures do not agree with those in Table 3, which are on a fiscal year basis.)

On the consumption side the divergence between industrial and household demand was stark. Because electricity use by manufacturers fell about 10.7 billion kilowatt-hours in 1990, demand by other users for power and light must have increased by 45.8 billion kilowatt-hours in order to yield a net growth of 35.1 billion kilowatt-hours for the year. Coming on top of a 34.9 billion kilowatt-hour increase the year before, 1990's growth in demand set off alarms at MITI and the utilities as peak capacity generation margins narrowed to uncomfortably thin levels (see JEI Report No. 18B, May 10, 1991). The disappearance of a comfortable capacity margin has spurred utilities to boost their capital spending plans and added urgency to the factors complicating the ongoing debate over nuclear power.

Japan's consumption of nonoil energy (Table 12) showed a checkerboard pattern in 1990. The appetites of the steel industry and the manufacturing

Table 12: Japan's Consumption of Imported Noncrude Oil Energy

(in thousands of units)

	Coal (mt)			Heavy Fuel Oil (kl)			
	Coke	Steel	Power	Agriculture	Manufacturing	Shipping	Power
1980	4,309	64,440	10,208	1,410	43,747	6,154	38,360
1981	5,197	64,650	13,972	1,044	35,690	4,730	34,508
1982	4,330	62,470	15,299	906	30,209	4,365	30,983
1983	4,551	57,368	18,063	1,051	27,769	4,112	29,476
1984	5,014	65,963	20,306	1,309	26,655	4,909	29,220
1985	5,821	66,344	23,988	1,303	24,853	4,709	22,271
1986	5,528	62,982	23,588	1,498	24,121	4,663	19,952
1987	4,652	59,221	14,237	1,708	24,787	4,784	18,411
1988	5,025	66,389	14,961	2,038	26,949	5,183	19,408
1989	4,856	64,258	15,827	2,058	27,430	5,570	21,482
1990	5,012	62,795	17,208	2,394	25,470	3,644	24,413

	LPG (mt)			LNG (mt)	
	Chemicals	Power	Motor Vehicles	Residential	Power
1980	4,485	3,327	1,548	3,180	12,554
1981	4,465	2,707	1,241	3,411	12,857
1982	4,465	2,707	1,241	3,411	12,857
1983	4,047	3,082	1,822	4,195	14,039
1984	5,029	3,381	1,843	5,561	19,606
1985	5,176	3,321	1,722	5,589	21,396
1986	5,292	3,417	1,728	6,228	21,458
1987	5,492	3,680	1,543	6,518	22,080
1988	1,640	4,374	1,460	6,804	23,393
1989	1,947	4,729	1,445	7,855	24,736
1990	2,359	4,390	1,876	8,242	26,772

Source: Ministry of International Trade and Industry

sector for coal and heavy fuel oil, respectively, were noticeably smaller than in the previous two years. As mentioned above, however, imports of these two fuels for power generation showed strong gains. The chemicals industry used more imported liquefied petroleum gas as a substitute for other feedstocks. Interestingly, Japan's efforts to promote liquefied petroleum gas as an automotive fuel received an apparent boost from the Persian Gulf crisis, as consumption in 1990 jumped sharply to a new record, reversing the gradual decline begun in 1985.

Despite the unavailability of full-year data for 1990, trends [illegible] energy consumption by households (Table 13) are evident. The data show that consumption of electricity for the first 11 months of 1990 almost had reached the level recorded for all of 1989. As for 1990 consumption of propane, kerosene and liquefied petroleum gas, the preliminary figures point to equal or slightly lower full-year levels as compared with the previous year. Heavier use of "cleaner" energy sources -- electricity, propane and LPG -- contrasted with the sharp reductions in consumption of coal, briquettes and other "dirty" fuels. Notwithstanding this trend, the increased rate of household energy use caught MITI planners off guard and upset long-term energy projections.

Table 13: Household Energy Consumption in Japan

	Electricity (mil kwh)	Propane (bil kcal)	Kerosene (1,000 kl)	LPG (1,000 mt)	Other Solids (1,000 mt)	Coal (1,000 mt)
1980	103,199	56,008	16,725	4,984	1,212.3	578.5
1981	108,979	58,178	16,730	5,336	970.0	472.5
1982	110,051	58,200	15,275	5,295	1,173.0	512.8
1983	117,905	60,748	15,928	5,460	1,010.3	509.2
1984	125,588	66,065	17,130	5,696	1,413.2	469.1
1985	129,682	65,706	16,060	5,611	1,479.3	371.9
1986	134,078	70,127	16,992	5,835	1,222.5	304.0
1987	141,531	69,799	16,556	6,114	969.9	228.3
1988	151,067	75,559	18,503	6,848	1,194.9	184.7
1989	159,819	76,338	17,296	6,907	1,107.5	140.3
1990	159,801*	76,448	12,218**	5,467**	806.5*	92.5*

*January-November only.
**January-October only.

Source: Ministry of International Trade and Industry

Best Laid Plans: Boon or Bane?

The degree to which energy demand has outdistanced the expectations of MITI energy analysts can be seen in the ministry's most recent long-term energy outlooks (Table 14). The October 1987 projection envisioned a 33.9 percent rise in total energy demand over the next two decades. Three years later the projected increase in total demand was raised to 38.2 percent. To the surprise of MITI planners total energy use in FY 1988 nearly had reached the level projected for FY 1995 in October 1987. In the midst of the Persian Gulf crisis the

Table 14: Long-Term Energy Outlook

(in millions of units as specified and percent share)

October 1987

	FY 1986		FY 1995		FY 2000		FY 2005	
	Units	Share	Units	Share	Units	Share	Units	Share
Coal (mt)	103.9	18.3%	121.0	18.3%	136.0	18.7%	150.0	19.0%
Nuclear (kw)	25.8	9.5	41.5	13.4	53.5	15.9	65.0	18.0
Natural Gas (kl)	42.8	9.9	55.0	11.1	58.0	10.8	60.0	10.0
LNG (kl)	28.8	6.7	36.0	7.3	38.0	7.1	---	---
Hydroelectric (kw)	35.8	4.2	42.5	4.5	45.5	4.4	48.5	4.0
Geothermal* (kl)	0.4	0.1	2.0	0.4	4.4	0.8	6.0	1.0
Alternatives* (kl)	5.5	1.3	12.5	2.5	24.5	4.5	52.0	9.0
Oil (kl)	246.0	56.8	245.0	49.7	242.0	45.0	240.0	42.0
Domestic (kl)	0.7	0.2	1.3	0.3	1.9	0.4	---	---
LPG (mt)	16.2	---	18.0	---	19.0	---	---	---
Total* (kl)	433.0	100.0	490.0	100.00	540.0	100.0	580.0	100.0

June 1990

	FY 1988		FY 2000		FY 2010	
	Units	Share	Units	Share	Units	Share
Coal (mt)	114.6	18.1%	142.0	17.4%	142.0	15.5%
Nuclear (kw)	179.0	9.0	330.0	13.2	474.0	16.7
Natural Gas (kl)	46.1	9.6	65.0	10.9	80.0	12.0
Hydroelectric (kw)	86.0	4.6	91.0	3.7	105.0	3.7
Geothermal* (kl)	0.4	0.1	1.8	0.3	6.0	0.9
Alternatives* (kl)	6.2	1.3	17.4	2.9	34.6	5.2
Oil (kl)	276.0	57.3	308.0	51.6	306.0	46.0
LPG (mt)	17.4	---	22.0	---	23.0	---
Total* (kl)	482.0	100.0	597.0	100.0	666.0	100.0

October 1991

	FY 1989		FY 2000		FY 2010	
	Units	Share	Units	Share	Units	Share
Coal (mt)	113.6	17.3%	142.0	17.5%	142.0	15.7%
Nuclear (kw)	183.0	8.9	330.0	13.3	474.0	16.9
Natural Gas (kl)	49.9	10.0	65.0	10.9	80.0	12.2
Hydroelectric (kw)	88.0	4.6	91.0	3.7	105.0	3.7
Geothermal* (kl)	0.4	0.1	1.8	0.3	6.0	0.9
Alternatives* (kl)	6.4	1.3	17.4	3.0	34.6	5.3
Oil (kl)	289.0	57.9	305.0	51.3	298.0	45.3
LPG (mt)	17.4	---	22.0	---	23.0	---
Total* (kl)	499.0	100.0	594.0	100.0	657.0	100.0

*Crude oil equivalent.

Source: Ministry of International Trade and Industry

ministry issued another long-range forecast, which modestl scaled back expected demand for oil in the year 2010. The ministry apparently hoped that the Persian Gulf crisis would lead to renewed conservation efforts and spur development of alternative energy sources, particularly nuclear power. Critics immediately charged that the latest projections were unrealistic.

MITI analysts are finding that their crystal balls were clouded in relation to other forecasts as well. A five-year outlook for petroleum product demand (Table 15) predicted an average annual increase of only 2.3 percent between FY 1988 and FY 1994. Between FY 1988 and FY 1990, however, demand ran almost half-again above MITI's estimate. The ministry probably will issue new long-term energy and petroleum product demand outlooks this summer.

Table 15: Five-Year Outlook for Japanese Demand for Petroleum Products

(in thousands of kiloliters and percent change)

Product	FY 1988 (estimated)	FY 1989 (projected)	FY 1989 Change	FY 1993 (projected)	1988-94 Average Annual Change
Gasoline	39,622	40,778	2.9%	44,284	2.2%
Naphtha	30,288	31,644	4.5	34,026	2.4
Jet Fuel	3,349	3,469	3.6	3,879	3.0
Kerosene	27,606	27,925	1.2	29,571	1.7
Light Fuel Oil	31,983	34,023	6.4	38,777	3.9
Fuel Oil A	25,138	26,265	4.5	28,821	2.8
Fuel Oil B	1,357	1,091	-19.6	557	-16.3
Fuel Oil C	43,810	46,389	5.9	47,502	1.6
Electric Power	20,919	23,231	11.1	24,018	2.8
Other	22,891	23,158	1.2	23,484	0.5
LPG*	17,117	17,549	2.5	18,948	2.1
Total	202,753	211,584	4.4	227,417	2.3

*In thousands of metric tons.

Source: Ministry of International Trade and Industry

An unusually hot summer last year pushed electric utilities to their limit, another indication that energy demand is expanding faster than expected. Peak demand in several metropolitan areas, including Tokyo, nearly exceeded generation capacity; some utilities were forced to implement emergency measures, including arrangements to buy excess power from neighboring power grids and agreements by large industrial users permitting their supplies to be cut on short notice. Although both ministry analysts and utility executives do not expect this summer to be as hot, they are reassessing capital investment plans that factor in greater household demand (see JEI Report No. 18B, May 10, 1991).

In contrast, MITI can claim that years of planning put Japan in an excellent position to deal with the fallout associated with the Persian Gulf crisis. Government and private oil reserves could have compensated for embargoed Iraqi and Kuwaiti crude for many months as Tokyo moved to release the reserves in concert with other oil-importing nations when prices for crude threatened to get out of hand. The strict monitoring of energy prices at both the wholesale and the retail level by MITI and other agencies sent a strong signal to oil companies that windfall profits would not be tolerated. MITI made it clear in discussions with refiners that the burden of higher oil prices must be borne by producers as well as consumers (see JEI Report No. 36B, September 21, 1990). Although Washington also sought to moderate price increases for gasoline and other energy supplies via moral suasion, it enjoyed less success.

MITI's handling of the energy repercussions of the Persian Gulf crisis might be considered too successful by some energy planners. In contrast to the panics that ensued after the oil shocks of the 1970s, the nation met the threat of an oil shortage with relative calm, based on assurances from government and industry spokesmen that Japan was ready for any contingency. Although prices for electricity and gasoline did rise, no actual shortages occurred nor were harsh government actions required. Since abatement of the crisis, consumers have watched energy prices begin to fall. The short duration of the crisis in combination with continued economic growth did not generate the same sense of urgency as the oil shocks of the 1970s did.

MITI Charges Up Energy Programs

The Persian Gulf experience has revitalized efforts to maintain energy policy near the top of Japan's national agenda. The likelihood that a regimen of fiscal austerity instituted by the Ministry of Finance in the early 1980s will remain in force for the coming decade, however, means that larger total outlays for energy measures are unlikely to materialize. Instead, MITI continues to cope by rearranging its budget to put money where it is needed.

According to MITI's requests for FY 1991, programs to facilitate imports of energy and help the domestic coal industry once again lost monies to programs designed to develop and introduce alternative energy sources. Coal industry support programs were cut a total of Y23.2 billion ($171.9 million at Y135= $1.00), while outlays for low-cost trade financing for energy imports and for oil industry rationalization programs were reduced. Funding for MITI's "moonlight" project, which targets energy conservation and efficiency technologies, grew from Y11.6 billion ($85.9 million) to Y11.9 billion ($88.1 million). Its counterpart "sunshine" project, which funds the development of alternative energy sources such as biomass conversion, received Y27.4 billion ($203 million). The request for renewable energy programs topped Y21.3 billion ($15.8 million). Small-scale, local alternative energy projects also enjoyed a boost to Y2.5 billion ($18.5 million) in FY 1991 to promote installation of photovoltaic and solar heating systems.

Given that petroleum will continue to play a major role in Japan's economy even if MITI fulfills its ambitious long-term plan to diversify energy sources, programs aimed at improving the efficiency of oil-using equipment remain an important part of the ministry's agenda. Funds to encourage industry to adopt more efficient equipment rose from Y31.2 billion ($231.1 million) in FY 1990 to Y34.6 billion ($256.3 million) in FY 1991. Greater attention also is being given to local projects in this field; funding for these nearly tripled to Y3.3 billion ($24.4 million) for the current fiscal year.

Nuclear power continues to be the apple of MITI's eye. According to the latest MITI outlook for electricity use and consumption, nuclear power will become the single largest source of electrical generating capacity in Japan in short order (Table 16). Because reactors must be shut down periodically for maintenance, however, atomic energy will supply only about a fifth of expected electricity consumption (Table 17). To achieve this ambitious goal the ministry is upping its nuclear power budget.

Table 16: Ten-Year Outlook for Electricity Generation Capacity by Fuel Source

(percentage of total capacity)

	FY 1990	FY 1995	FY 2000
Oil	27%	22%	17%
Liquefied Petroleum Gas	1	1	1
Liquefied Natural Gas	22	21	22
Coal	9	12	17
Nuclear	26	31	31
Hydroelectric	12	11	10
Other	3	3	3

Source: Ministry of International Trade and Industry

Table 17: Ten-Year Outlook for Electricity Consumption by Fuel Source

(percentage of total capacity)

	FY 1990	FY 1995	FY 2000
Oil	31.2%	26.7%	22.4%
Liquefied Petroleum Gas	0.6	0.5	0.6
Liquefied Natural Gas	22.1	21.4	24.2
Coal	7.1	9.9	12.5
Nuclear	18.0	20.4	21.0
Hydroelectric	20.8	20.8	18.9
Other	0.1	0.2	0.3

Source: Ministry of International Trade and Industry

Since funding is split among various categories in the general account budget and also is provided through a special energy account and other semigovernmental organizations, such as the Japan Development Bank, it is difficult to get a clear picture of the government's net spending for nuclear power. General account outlays for nuclear power, for example, showed gains for almost all line items in FY 1991, including safety measures (Y22.8 billion or $168.9 million) and spent fuel reprocessing (Y5.4 billion or $40 million). The Japan Development Bank's FY 1991 budget for nuclear energy promotion is Y210 billion ($1.6 billion), up Y10 billion ($74.1 million) from the year before. The Energy Special Account provides another Y41.4 billion ($306.7 million) for nuclear safety and reactor development plus Y539 million ($4 million) for nuclear fuel cycle research. All this money, however, may be for naught if MITI cannot win wider public acceptance of nuclear power.

The Nuclear Option: Exercise Or Exorcise?

As the only people to suffer the effects of nuclear weapons the Japanese appear ambivalent toward nuclear power. While the horrors of Hiroshima and Nagasaki are kept fresh in their minds, the country's lack of energy resources and near-total dependence on imported fuels also is of great concern. Calling nuclear power the wave of the future, the central government has authorized the construction of nearly 40 nuclear power plants over the last 20 years.

To MITI officials the latest jewel in Japan's nuclear power crown is the newly dedicated fast-breeder reactor at Tsuruga in Fukui prefecture. Nicknamed after a kind of dome-shaped steamed bun common in Japan, the Monju project is the result of six years of entirely domestic design work; it will produce more fuel (in the form of plutonium) than it consumes. Dedicated May 18, Monju will be brought to criticality in October 1992 before coming on-line at full power in 1994; its designed output is 280,000 kilowatts. Monju is particularly controversial, however, because it will produce weapons-grade plutonium and because facilities to recover the plutonium have not yet been built. A local citizens group hopes to block the reactor's start-up in court.

While the Monju project represents a strictly domestic design, many of Japan's nuclear plants have had substantial U.S. input. The country's first advanced boiling water reactor is no exception. After a rigorous safety review MITI recently gave the green light to General Electric Co. and its Japanese partners, Hitachi, Ltd. and Toshiba Corp., to begin work on a reactor that has been in the development stage for over 10 years in cooperation with Tokyo Electric Power Co., Inc. The 1,356-megawatt unit, which will be located northwest of Tokyo, is touted as being safer as well as simpler to build and operate than previous designs. It represents GE's first significant contract for a nuclear power plant in more than 15 years.

MITI's 10-year outlook, which calls for a sharp increase in nuclear power's share of electricity generation, requires the addition of at least 40 reactors of 1-megawatt capacity or more to the current 39 operable plants. Due to public fears of nuclear power, however, only 14 have been sited or are under construction. The arguments in the debate over nuclear power have not changed since nuclear power plants began producing electricity. Safety clearly is the most important issue, but cost and environmental effects also must be addressed.

- Safety - Japanese nuclear plants, whether boiling water or pressurized water reactor types, have a record of high operating rates (Table 18). Japan compares favorably with most other industrialized nations that use nuclear power, ranking in the top three by operating rate even though it has significantly more plants than its closest competitors (Table 19). (The number of plants and the time required for maintenance and refueling are positively related.) Japan's safety record is equally exemplary. The number of reported troubles has been below one per reactor per year since 1989 despite the fact that the number of reactors in operation has grown (Table 20). Experts point to careful construction, conservative operating procedures and detailed maintenance programs as the foundation of Japan's good safety record.

Table 18: Average Operating Rate of Japanese Nuclear Power Plants

(in percentage of rated capacity; number of plants in parentheses)

Year	Boiling Water Reactors	Pressurized Water Reactors	Average*
1981	62.3%	60.0%	61.3%
	(11)	(10)	(22)
1982	70.7	69.8	70.2
	(12)	(11)	(24)
1983	67.4	72.9	70.0
	(14)	(12)	(27)
1984	73.6	70.7	72.3
	(16)	(15)	(32)
1985	74.1	74.6	74.2
	(16)	(15)	(32)
1986	72.0	81.1	76.2
	(16)	(15)	(32)
1987	79.5	79.5	79.4
	(18)	(16)	(35)
1988	72.1	68.4	70.4
	(18)	(16)	(35)
1989	71.4	73.9	72.3
	(19)	(17)	(37)
1990	68.1	75.3	71.2
	(21)	(17)	(39)

*Includes gas-cooled reactors.

Source: Ministry of International Trade and Industry

Table 19: International Comparison of Nuclear Reactor Utilization

(percentage of rated capacity; number of plants* in parentheses)

	1985	1986	1987	1988	1989	1990
Japan	74.2%	76.2%	79.4%	70.4%	72.3%	71.2%
	(32)	(32)	(35)	(35)	(37)	(39)
United States	60.1	58.3	59.6	63.5	62.0	65.9
	(87)	(92)	(99)	(106)	(108)	(110)
France	71.4	69.9	64.9	61.2	64.5	66.3
	(43)	(44)	(48)	(52)	(54)	(55)
England	54.7	52.2	47.3	52.3	52.4	50.0
	(27)	(28)	(28)	(31)	(32)	(30)
West Germany	85.8	78.3	78.8	75.3	72.3	71.0
	(16)	(17)	(18)	(20)	(21)	(21)
Canada	68.3	73.6	70.9	75.5	73.6	64.3
	(15)	(17)	(18)	(18)	(18)	(19)
Sweden	74.6	80.5	76.0	78.5	73.1	75.2
	(12)	(12)	(12)	(12)	(12)	(12)

*135 megawatts or greater.

Source: Ministry of International Trade and Industry

Table 20: Safety Record of Japanese Nuclear Reactors

	1985	1986	1987	1988	1989	1990
A. Summary Statistics						
Number of:						
Reactors	32	33	35	36	37	39
Average Annual Inspection Days	139	134	118	135	155	171
Incidents Reported by Law	19	19	19	23	22	23
Other Reported Incidents	28	30	22	25	13	12
Total Reported Incidents	47	49	41	48	35	35
Incidents per Reactor	1.3	1.4	1.2	1.3	0.9	0.9
B. Incidents Reported by Law by Reactor Type						
Reactor Type:						
Boiling Water	10	5	8	8	9	12
Pressurized Water	8	11	10	12	12	10
Gas Cooled	1	3	1	3	1	1
Total	19	19	19	23	22	23
C. Incidents Reported by Law by Classification						
Reactor Operating						
Automatic Shutdown	4	5	4	4	1	4
Manual Shutdown	8	6	7	9	10	9
Reactor Not Operating						
Damage to Steam System	6	7	5	5	9	9
Damage to Other Equipment	1	1	1	5	1	1
Other	0	0	2	0	1	0

Source: Ministry of International Trade and Industry

Two incidents in 1990, however, blemished the industry's reputation. When a tiny bit of radioactive water escaped from Kansai Electric Power Co., Ltd.'s reactor in Mihama, Fukui prefecture, operators took an unacceptable amount of time to detect and react to the situation with Japan's first-ever use of an emergency cooling system. An inspection of the reactor cooling system revealed that some supporting structures had been improperly installed. As a result, 16 other plants of similar design were combed for the same fault, and one, another KEPCO reactor at Takahama, Fukui prefecture, was closed quickly for repairs after it was found to have a similar problem. Despite the relatively minor nature of the fault, the incidents focused attention on the age and the maintenance needs of Japan's nuclear reactors. Of the 37 still in operation, 20 were built before 1980. As Table 20 shows, the average number of days required for inspection and maintenance stood at 171 in 1990 compared to 139 in 1985. Although MITI is funding research into reactor designs that incorporate intrinsic safety features, most of the reactors now in the planning stage are of traditional design. Until MITI can offer more convincing safety arguments, fear of nuclear accidents will remain a major stumbling block in the way of new reactors.

Public concern over the safe disposal of spent nuclear fuel also is growing. Unlike the United States, Japan does not have remote unpopulated areas that can serve as waste disposal sites. Moreover, Japan is located in an area of great geological activity. Earthquakes and volcanic eruptions make land or sea burial of radioactive materials less safe. Environmentalists already are opposing construction of Japan's first reprocessing facility at Rokkasho, Aomori prefecture. MITI has yet to begin addressing these safety concerns, but if the American situation is any guide, the subject will be controversial.

- Cost - Although the phenomenon of cost overruns has not plagued the nuclear construction industry in Japan as it has in the United States, the issue of the total operating costs over the life of a reactor is becoming more important. Communities where plants are being built are demanding more concrete benefits that will continue after construction is complete. This can add significantly to a reactor's total cost. Maintenance needs, as mentioned above, are growing perhaps faster than expected, adding to the total cost. Fuel costs also are growing, although not necessarily for usable fuel. Rather, the growing costs of storing and/or reprocessing spent fuel pose a problem. Development of a domestic reprocessing capability is continuing, and the government hopes to begin building its first commercial-scale facility within 10 years. This will reduce the need to ship spent fuel overseas for reprocessing. In the meantime, storage locations for spent fuel that is not sent for reprocessing are nearing capacity, and more will have to be built. Finally, the cost of closing nuclear plants will increase as more plants reach the end of their useful lives. How all these extra costs will be distributed among the government, the utilities and their customers remains to be worked out.

- Environmental Issues - MITI touts the nuclear option as an important part of its strategy to address the "greenhouse effect," in which increased levels of carbon dioxide and other gases in the atmosphere are said to trap the sun's heat and cause global temperatures to rise. To most environmentalists, however, building more nuclear power plants to cut emissions of CO_2 is a clear case of the treatment being worse than the cure. But if not enough nuclear power plants are built, Japan may be unable to achieve its ambitious goal of stabilizing CO_2 emissions by the year 2000 (see JEI Report No. 6B, February 15, 1991). The potential environmental damage from a major reactor accident is difficult to calculate, but the example of the 1986 Chernobyl incident in the Soviet Union remains fresh in the minds of the average Japanese. The question of spent fuel disposal also enters the environmental arena because of the extremely long lifetime of the radioactive waste. An environmentally sound waste disposal method has yet to be developed, as far as most environmentalists are concerned.

It is not clear whether MITI is equipped to handle these safety, cost and environmental concerns. With its traditional bias toward the needs of industry, the ministry may not have given adequate weight to these sensitive problems in its policy planning process. Prime Minister Toshiki Kaifu is on record that Japan will play a major role in solving global environmental issues; numerous requests in the FY 1991 budget for environment-related projects back this commitment. The growing domestic awareness about the safety and the costs of nuclear power, however, conflict with MITI's traditional goals of economic growth and industrial development. And MITI, not the Environment Agency, regulates the nuclear power industry.

New Initiatives and New Problems

Indeed, MITI is being challenged with problems and pressures well outside its traditional ken but intimately linked to energy policy. Particularly as a consequence of Japan's status as an economic superpower, energy policy is taking on the appearance of foreign policy in some cases. In nonmilitary areas especially, Japan hopes to carve out a leading global role. Some examples of these new challenges and responses include:

- Conservation - Besides trying to regulate excessive energy consumption through its spending priorities, MITI is firing up a public relations campaign to remind the average citizen that every bit of energy conserved helps. As part of its latest long-term energy outlook, the General Energy Research Council, a MITI advisory body, recalled a long string of earlier government energy-saving hints, including: adoption of clothing styles that would conserve energy (presumably by being cooler or warmer to wear); using air conditioners for only one month during the summer; turning off one-third of all interior lights; turning off all outdoor lights after 10 p.m.; closing gas stations on holidays; closing bars and night clubs at the scheduled hour; stopping television broadcasts after midnight; asking motorists not to use highways during holidays; and turning off all types of electrical appliances after every use.

Since it is highly unlikely that Japanese consumers of the 1990s would accept these restrictions except under extreme circumstances, the council suggested even greater emphasis on energy efficiency. One trend among young Japanese women, for example, is to wash their hair every day; the council has calculated that this uses energy equivalent to 735,000 kiloliters of crude oil every year. More efficient hair dryers and hot water heaters could make a dent in this amount. With air conditioners now installed in about half of all Japanese households and sales zooming, the council set a goal of saving 12.5 million kiloliters of crude oil equivalent through more efficient cooling systems.

Another move under study is to adopt daylight savings time in the summer months. Briefly used in Japan during the American occupation the system has been dormant since then. The council projected a savings of 320,000 kiloliters of crude oil equivalent a year from this change. The prospects that even these modest conservation proposals will succeed are not considered high by government planners. It is difficult to predict the technological advances necessary to improve efficiency. Moreover, some are politically sensitive, like daylight savings time. (The Labor Ministry fears it only will encourage employers to lengthen working hours, counter to the ministry's goal.)

- International Energy Agency - The IEA, formed in 1974 by 21 industrialized oil-consuming nations in response to the establishment of the Organization of Petroleum Exporting Countries, has become a center of activity since the Persian Gulf crisis began. Tokyo has assumed a more prominent role in urging IEA members to take further steps to cushion future oil crises, even going so far as to support talks between the agency and OPEC (a step opposed by the United States and Great Britain). Tokyo, this time along with the United States, also successfully lobbied to have the IEA-proposed European Energy Charter opened to all interested nations. The charter seeks to formalize the exchange of Soviet oil and gas for economic assistance. Tokyo also is pushing the IEA to adopt guidelines encouraging nuclear power and curbing CO_2 emissions.

- Nuclear Proliferation - Although not often classified as a safety issue, Iraq's nascent nuclear weapons capability, much discussed after Baghdad invaded Kuwait, reminded every Japanese of the dual uses of nuclear power. Because of its experience in World War II, Japan sees itself as well qualified to preach the dangers of nuclear proliferation. In recent months Japanese officials have been more forward in using Japan's economic power to try to stem nuclear proliferation. Tokyo, for example, currently is negotiating improved ties with Pyongyang. North Korea would like to have access to the giant Japanese market, to Japanese capital and to Japanese technology. Before advancing with talks, however, Tokyo insisted that Pyongyang agree to allow inspections of its nuclear facilities by officials of the International Atomic Energy Agency. North Korean representatives initially blasted Japan's stance with harsh rhetoric. But Tokyo stood firmly in line with the United States and South Korea in demanding unconditional inspections. Pyongyang announced in mid-June that it would yield to the demand but then hedged its commitment, linking it to a withdrawal of U.S. nuclear weapons from South Korea. Similarly, Tokyo soon will ink a nuclear safety and technology cooperation pact with China; again, it is insisting on safeguards against the technology being used for military purposes.

- Cooperative Nuclear Research - Cooperation between Japan and the United States in the area of nuclear power certainly is not a new development. Joint projects on reactor design and fuel reprocessing are numerous and longstanding. The International Tokamak Experimental Reactor, however, is a significantly different test of Japan's commitment to cooperative research. The United States and the Soviet Union proposed the ITER idea in 1985. Japan and the European Community signed on soon after this, and joint research commenced in 1988. The conceptual design has been completed, and the partners now are preparing to invest $750 million over the next several years on a detailed engineering plan. Washington, Tokyo and Brussels are deadlocked, however, each demanding that this engineering take place within its own borders. The apparent reasoning is that construction of the reactor will take place close to where the design is developed. The Soviet Union's opinion clearly will be an important factor in resolving this issue. Although it is possible to split the design team among several locations, everyone agrees that this would be inefficient.

Conclusion

Japanese energy policy appears to be entering middle age. The earlier drive for conservation and increased efficiency has yielded such positive results that energy policy no longer tops the national agenda. The Persian Gulf crisis was not enough to resurrect energy as a primary concern, but it was sufficient to revitalize MITI's attention to energy policy. Further gains in energy efficiency, however, will be difficult to come by for two reasons. First, Japanese industry already has made major strides, making improvement harder to achieve. Second, the country's new preoccupation with raising the standard of living translates into greater, not less, demand for energy; that is not hospitable to conservation efforts. In other areas, however, Japan's energy policy

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Yen's Downward Drift Complicates Japanese Monetary Policy

For more than six months many of those who make a living following the actions of the Bank of Japan confidently have predicted that Japan's central bank would ease monetary policy within days or weeks. As the weeks have stretched into months and neither the looser monetary policy nor, by extension, the lower interest rates have materialized, these experts have sought solace in a string of extenuating circumstances. At first, there was the explanation that BOJ needed time to assess the effects of the last hike, August 30, 1990, in the central discount rate. Then, they found explanations in the special problem of high oil prices and the associated threat of inflation. Most recently came the suggestion that a plunge toward looser monetary policy could follow the release of BOJ's new quarterly short-term economic survey (tankan), which reflects conditions in May and is released in early June. As of mid-June, however, BOJ officials have had almost 10 months to analyze the effects of the last discount rate hike, oil prices have settled back down and the latest tankan is in the hands of news reporters and number crunchers. Yet the BOJ watch continues, with no clear move to date toward an easing of monetary policy.

investment is neither good nor bad, he believes that competitors in the Far East see investing in a "small cash-strapped U.S. company" as a way to invest in leading technology. His colleague, Linda Spencer, outlined the results of an ESI study on foreign acquisitions in the United States. Among ESI's findings was that Japanese companies were responsible for more than half of the foreign investments in U.S. high technology firms in the last two-and-a-half years. The study was released in mid-May in conjunction with a bill introduced by Reps. Mel Levine (D, Calif.) and Frank Wolf (R, Va.). The Levine-Wolf measure also would tighten the review process for foreign acquisitions; the bill, another attempt to amend Exon-Florio, makes economic security an explicit criteria in assessing the impact of such purchases.

The panel heard several arguments against the Collins bill. Christopher Wall, a partner in the New York law firm of Winthrop, Stimson, Putnam and Roberts, which has represented companies involved in many of the national security reviews conducted by CFIUS, said the measure would "intensify uncertainty and unease in the foreign investment community" and would invite retaliation against American firms in other countries. Stephen Cooney, director of international investment and finance with the National Association of Manufacturers, voiced NAM's opposition to the bill, saying that "a complicated and mandatory review process would be damaging" both to "U.S. companies seeking access to foreign markets and to those seeking partnerships with foreign-owned companies."

Lending his support to a strengthened review process was Peter Mills, the former chief administrative officer of SEMATECH, the government-industry research and development alliance aimed at boosting U.S. semiconductor manufacturing technologies. Mr. Mills stressed that U.S. national security is being jeopardized by numerous foreign purchases of companies with key technologies and that "CFIUS should be required to consider the cumulative effect of multiple transactions." He argued that Japan has a very well thought-out strategy to target the semiconductor industry and its supplier base, although, he added, SEMATECH is not necessarily fighting an unwinnable battle. Andrew Lorenz, chief executive officer of Plasma Chem Inc., also cautioned that the sale to foreign competitors of companies making semiconductor manufacturing equipment and materials jeopardizes "the ability of the United States to compete, domestically and globally, in technological 'anything.'"

The subcommittee is expected to weigh the language of and consider possible amendments to the Technology Preservation Act before long. Although the threat of a presidential veto is likely to be a factor as lawmakers review this particular bill, congressional concern that the United States is losing control over critical technologies appears to be gaining momentum. In addition to the Collins and Levine-Wolf measures, a bill introduced by Rep. Ralph Regula (R, Ohio) in late May would establish a Critical Technologies Commission to determine whether certain imports and foreign investments pose a threat to national security.

Margo Grimm

Big Three Charge Japanese Rivals With Dumping Minivans

Detroit's high-profile Washington campaign for trade and regulatory relief took an unexpected turn May 31 when General Motors Corp., Ford Motor Co.

and Chrysler Corp. formally accused Japanese manufacturers of selling minivans here for less than at home. Rumors had been circulating for some time that one or perhaps all of the Big Three automotive makers would bring an antidumping case against Japanese suppliers; depending on the source of the rumor, luxury cars, compact pickup trucks, small sports-utility vehicles or minivans were said to be the most likely target. But many trade and industry analysts interpreted this talk as just a new tactic in the drive spearheaded by Chrysler chairman Lee Iacocca to get Japanese producers to ease up on car exports (see JEI Report No. 13B, April 5, 1991). Secretary of Commerce Robert Mosbacher's early April statement in Tokyo that the Bush administration would enforce U.S. antidumping laws with regard to the pricing of Japanese-made cars was viewed the same way.

Analysts had several reasons for thinking that the latest round of talk about dumping was designed to scare Japanese competitors into restraining shipments across-the-board. Even if an antidumping petition were filed and the Department of Commerce found less-than-fair-value sales by one or more Japanese makers in the product segment targeted, domestic manufacturers would have a hard time convincing the International Trade Commission that unfair pricing was a major cause of the U.S. industry's problems in that part of the market. The difficulty of establishing a credible causal link was one reason the Motor Vehicle Manufacturers Association never filed the antidumping complaint against Japanese-made compact pickups that it had commissioned in early 1988 (see JEI Report No. 15B, April 15, 1988). Admittedly, U.S. market conditions have flip-flopped in the intervening three years but, according to this line of thought, Detroit still would have trouble proving that the actions of foreign competitors were a significant cause of the Big Three's current woes.

The multiple financial and/or production ties between the American and the Japanese automotive industries also would make Detroit think twice about going the trade-complaint route, analysts figured, no matter what suspicions there might be that Japanese motor vehicle manufacturers still have not raised their U.S. prices enough to cover the dollar's drop against the yen in the second half of the 1980s. Struggling Chrysler not only has a 12.5 percent equity interest in Mitsubishi Motors Corp. but is dependent on its Japanese affiliate for certain car and truck products. It also is negotiating with MMC to take a bigger financial stake in their now equally owned Illinois car plant. Likewise, Ford owns 25 percent of Mazda Motor Corp., which supplies the number-two car maker with the Probe from its Michigan plant and helped Ford redesign the Escort. Ford, in turn, builds the Navajo sports-utility vehicle for Mazda. Next year it will start building a minivan designed by Nissan Motor Co., Ltd. for U.S. sale by both companies. For its part General Motors has minority interests in both Isuzu Motors Ltd. and Suzuki Motor Co., Ltd. The U.S. industry leader also splits ownership of a sports-utility plant in Canada with Suzuki and a car plant in California with Toyota Motor Corp.

Trade and industry analysts also were skeptical whether all three U.S. automotive makers would sign off on an antidumping complaint, an industry first regarded as necessary to improve the poor odds of a successful case. (The lone motor vehicle antidumping case to date, an unsuccessful 1975 complaint against cars made in Europe, Canada and Japan, was initiated by a congressman with the support of the United Auto Workers union. The only other trade complaints involving motor vehicles, two failed 1980 investigations covering cars and light trucks from all countries, were filed by the UAW and Ford.) Chrysler certainly would be no problem. Ford also was thought likely to join in. The big question was GM, which not only has steered clear of the anti-Japan statements made by Chrysler and, to a lesser extent, Ford but has backed free trade as well.

Detroit's decision to file an antidumping complaint against Japanese exporters was not the only surprise in store for a cross section of trade and industry watchers. A number of analysts also were surprised by the choice of a truck product and especially minivans. GM, Ford and Chrysler are much stronger in light trucks than cars. Last year, for example, American nameplates took 83.6 percent of the 4.6-million-unit U.S. light-truck market versus 65.8 percent of the 9.3 million cars sold here. The Big Three have about 40 percent of the light-truck market to themselves since Japanese manufacturers do not compete in the full-size pickup, van and sports-utility vehicle segments. U.S. companies also have successfully fought back in the big market for compact pickups, which was pioneered by their Japanese rivals; in 1990 American nameplates captured 57.6 percent of sales. They have done even better in small sports-utility vehicles, controlling 75.3 percent of the market last year. The best showing by GM, Ford and Chrysler in compact trucks, however, has been in minivans, a segment carved out by Chrysler in 1983 (see Table).

U.S. Sales of Minivans, 1988-91*

(in units)

	1988	1989	1990	Five Months 1990	Five Months 1991
Plymouth Voyager	192,273	184,943	171,527	78,723	68,901
Dodge Caravan	210,918	206,426	195,276	89,029	83,938
Dodge Caravan C/V	19,222	13,150	10,680	6,311	4,649
Chrysler Town & Country	0	1,812	2,891	1,320	1,580
Ford Aerostar	184,578	188,130	177,860	78,701	60,067
Chevrolet Astro	156,833	143,941	121,168	55,838	46,716
Chevrolet Lumina APV	0	9,776	63,141	25,920	19,872
Pontiac Trans Sport	0	3,226	29,875	12,722	8,551
Oldsmobile Silhouette	0	2,122	26,075	9,069	10,838
GMC Safari	33,168	31,681	34,300	13,877	13,203
American Nameplates	796,992	785,207	832,793	371,510	318,315
Mazda MPV	n.a.	32,277	43,147	15,831	21,010
Mitsubishi Van	n.a.	910	739	398	54
Nissan Axxess and Van	n.a.	13,185	7,877	3,686	290
Toyota Previa and Van	n.a.	10,075	42,431	12,433	21,883
Japanese Nameplates	n.a.	56,447	94,194	32,348	43,237
VW Vanogan	n.a.	5,147	6,643	2,929	2,347
Total Sales	818,741	846,801	933,630	406,787	363,899
American Market Share	97.3%	92.7%	89.2%	91.3%	87.5%
Japanese Market Share	n.a.	6.7%	10.1%	8.0%	11.9%

*The figures for Japanese nameplates do not agree with those used in the Big Three's antidumping petition.

Source: Automotive News

U.S. industry sources cite two reasons for Detroit's unexpected choice of minivans. Although the Big Three reportedly thought they had a good chance of winning a case against Japanese manufacturers in any of the three compact truck segments, minivans provided the best case -- in part, apparently, because the dumping margins on these products were bigger than for pickups and sports-utility vehicles. In its petition the U.S. industry estimates the difference in ex-factory prices for Toyota Previas sold in the United States and in Japan at 5.4 percent to 30.5 percent; similar calculations for Mazda's MPV produce a range of 14.8 percent and 27 percent. If anything, the Big Three add, these figures err on the side of conservatism. (Mitsubishi and Nissan also are mentioned in the complaint but only because they shipped some minivan-like vehicles to this country during the period examined.)

More importantly perhaps, the U.S. industry opted for minivans because these products are one of the few continuing sources of profits in an otherwise bleak financial picture. (Chrysler, admittedly the extreme example, is said to make up to half of its money off of minivans.) But the future profitability of minivans now is in jeopardy because of the U.S. market inroads made by Toyota and Mazda with the help of unfair pricing, the Big Three charge in their petition. GM, Ford and Chrysler acknowledge that the recession has made market conditions difficult, but they blame Toyota and Mazda for compounding their problems. "Precisely because the rise in imports from Japan has coincided with a downturn in the U.S. minivan market, it has aggravated industry problems at a time when U.S. producers are most vulnerable to dumping."

Included in the petition are seven industry indicators that purport to prove that American makers of minivans are in serious trouble because of unfair pricing by Toyota and Mazda, but the evidence of injury is hardly conclusive. Yes, production and sales of American-made minivans are running below last year's levels, but 1990 was a record production/sales year for domestic producers. Similarly, minivan net profits have dropped since 1988, but U.S. light-truck sales also reached an all-time high that year.

GM, Ford and Chrysler actually admit in their petition that they are more concerned about the possibility of injury in the future from dumped minivans made in Japan than about the current impact of unfairly priced Previas and MPVs. That admission is one reason some analysts have labeled the antidumping complaint a preemptive strike -- an attempt to persuade Toyota and Mazda to abandon plans for expanded U.S. minivan sales and, at the same time, to keep other Japanese manufacturers from entering the American minivan market. But formally charging Japanese competitors with dumping to get them to back off is a high-risk strategy. If, as Japanese automotive executives and numerous analysts predict, the U.S. industry loses the minivan case, it no longer will be able to use the threat of an antidumping suit to alter the U.S. marketing plans of Japan's motor vehicle manufacturers in any segment.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

Table 1: Japan's Foreign Direct Investment by Country, FY 1986-FY 1990

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	Cumulative March 31, 1991
United States	$10,165	$14,704	$21,701	$32,540	$26,128	$130,529
Canada	276	653	626	1,362	1,064	5,656
North America	10,441	15,357	22,328	33,902	27,192	136,185
United Kingdom	984	2,473	3,956	5,239	6,806	22,598
Netherlands	651	829	2,359	4,547	2,744	12,816
Luxembourg	1,092	1,764	657	654	224	5,607
West Germany	210	403	409	1,083	1,242	4,589
France	152	330	463	1,135	1,257	4,156
Switzerland	91	224	454	397	666	2,495
Spain	86	283	161	501	320	1,887
Belgium	50	70	164	326	367	1,720
Italy	23	59	108	314	217	900
Europe	3,469	6,576	9,116	14,808	14,294	59,265
Indonesia	250	545	586	631	1,105	11,540
Hong Kong	502	1,072	1,662	1,898	1,785	9,850
Singapore	302	494	747	1,902	840	6,555
Thailand	124	250	859	1,276	1,154	4,422
South Korea	436	647	483	606	284	4,138
Malaysia	158	163	387	673	725	3,231
China	226	1,226	296	438	349	2,823
Taiwan	291	367	372	494	445	2,731
Philippines	21	72	134	202	258	1,580
Asia	2,327	4,868	5,569	8,238	7,054	47,519
Panama	2,401	2,305	1,712	2,044	1,342	16,244
Caymans	930	1,197	2,609	1,658	588	7,332
Brazil	270	229	510	349	615	6,560
Bahamas	792	734	737	620	121	3,459
Mexico	226	28	87	36	168	1,874
Bermuda	16	36	337	228	380	1,578
Netherlands Antilles	66	199	172	38	9	795
Peru	---	1	---	---	---	696
Latin America	4,737	4,816	6,428	5,238	3,628	40,483
Australia	881	1,222	2,413	4,256	3,669	16,063
New Zealand	93	121	117	101	231	925
Oceania	992	1,413	2,669	4,618	4,166	18,098
Liberia	289	267	648	643	531	4,832
Africa	309	272	653	671	551	5,826
Kuwait	41	54	20	32	26	1,441
Iran	---	---	1	1	---	1,006
Middle East	44	62	259	66	27	3,431
Total	22,320	33,364	47,022	67,540	56,911	310,808

Source: Ministry of Finance

Table 2: Japan's Foreign Direct Investment by Sector, FY 1986-FY 1990

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	Cumulative March 31, 1991
Manufacturing Sector	$3,806	$7,832	$13,805	$16,284	$15,486	$81,613
Food Products	127	328	419	1,300	821	4,085
Textiles	63	206	317	533	796	3,999
Wood and Paper Products	57	317	604	555	314	2,969
Chemicals	355	910	1,292	2,109	2,292	10,940
Metals	328	786	1,367	1,591	1,047	10,308
Nonelectric Machinery	626	687	1,432	1,762	1,454	7,932
Electric Machinery	987	2,421	3,041	4,480	5,684	20,360
Transport Equipment	828	1,473	1,281	2,053	1,872	10,880
Other	435	703	4,051	1,901	1,207	10,138
Nonmanufacturing Sector	17,949	25,080	32,634	50,517	40,620	223,136
Agriculture and Forestry	15	97	162	151	153	1,358
Fisheries	52	44	94	47	61	739
Mining	669	511	1,013	1,262	1,328	16,539
Construction	250	87	309	646	300	2,389
Trade and Sales	1,861	2,269	3,204	5,148	6,156	31,315
Banking, Finance and Insurance	7,240	10,673	13,104	15,395	8,047	65,319
Services	1,560	2,780	3,732	10,616	11,292	34,667
Transportation	1,925	2,145	2,372	2,927	2,169	17,438
Real Estate	3,997	5,428	8,641	14,143	11,107	45,849
Other	379	1,047	3	180	6	7,523
Branch Offices	566	452	584	739	806	5,464
Other Transactions*	---	---	---	---	---	595
Total	22,320	33,364	47,022	67,540	56,911	310,808

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

Table 3: Japan's Foreign Direct Investment by Industry and Region, March 31, 1991

(in millions of dollars)

	North America	Europe	Asia	Latin America	Oceania	Africa	Middle East	Total
Manufacturing Sector	$40,322	$12,540	$18,659	$6,281	$2,302	$231	$1,277	$81,613
Food Products	1,831	520	1,167	267	293	8	0	4,085
Textiles	759	865	1,867	452	12	39	4	3,999
Wood and Paper Products	2,061	20	525	205	157	1	-	2,969
Chemicals	4,824	1,415	2,641	775	131	24	1,130	10,940
Metals	4,183	599	2,804	2,074	455	127	66	10,308
Nonelectric Machinery	3,973	1,794	1,649	424	80	1	11	7,932
Electric Machinery	11,099	4,321	4,175	638	104	8	15	20,360
Transport Equipment	5,030	1,899	1,699	1,284	947	17	4	10,880
Other	6,563	1,108	2,132	161	123	7	46	10,138
Nonmanufacturing Sector	94,291	44,688	28,074	34,132	15,654	5,591	706	223,136
Agriculture and Forestry	448	16	330	223	332	7	2	1,358
Fisheries	186	21	195	152	81	102	1	739
Mining	2,089	1,559	7,357	1,605	2,947	582	401	16,539
Construction	1,176	117	740	223	70	23	40	2,389
Trade and Sales	16,983	6,700	3,792	2,179	1,602	15	44	31,315
Banking, Finance and Insurance	19,393	25,129	4,231	14,651	1,755	37	123	65,319
Services	20,741	3,264	5,703	1,485	2,743	725	5	34,667
Transportation	510	229	1,095	12,201	167	3,233	2	17,438
Real Estate	30,549	6,597	2,991	211	5,432	69	-	45,849
Other	2,215	1,058	1,638	1,203	524	798	87	7,523
Branch Offices	1,086	1,999	750	46	136	1	1,446	5,464
Other Transactions*	485	38	37	23	7	2	2	595
Total	136,185	59,265	47,519	40,483	18,098	5,826	3,431	310,808

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980.

Source: Ministry of Finance

NOTE

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JAPANESE POLITICAL REFORM: IS IT JUST A MIRAGE?

Summary

Japanese politicians, particularly at the national level, may not enjoy much of a vacation this summer. In fact, this could be a rather disquieting period for members of the ruling Liberal Democratic Party as well as the opposition parties. Prime Minister Toshiki Kaifu has indicated that he intends to convene an extraordinary Diet session in late July to consider legislation that would change Japan's electoral system, among other measures.

Aimed at improving the efficiency and the transparency of the current multiseat electoral system, the proposed reforms would reduce the number of seats in the Diet's powerful lower house and make over half of the remainder into single-seat districts. While virtually all political parties would suffer in some form under the new plan, the opposition parties would be especially hard hit. Political analysts maintain that these reforms, if enacted, could bring about a significant transition in postwar Japanese politics.

Although recognizing the probability of strong resistance from the political opposition as well as from within his own party, Mr. Kaifu nevertheless is moving forward to reform the electoral system. The prime minister ultimately may lose his never-secure position of power regardless of what happens to the political reform bill. Ruling party elders have lost patience with Mr. Kaifu, who had been their compromise candidate, propelled to the top slot in August 1989 following the Recruit Co., Ltd. influence-peddling scandal. Party doyens again feel the time is right for their own shots at the premiership when Mr. Kaifu's

term expires in October. By summer's end a different set of players may emerge, possibly forcing Japan's political system to consider a new direction, or -- as often has been the case during the postwar period -- the maneuvering simply may reaffirm the status quo.

Atoning for the Recruit Scandal

When Prime Minister Toshiki Kaifu said early last year that he would stake his administration on enactment of a plan to reform Japan's electoral system, an outside observer might have been struck by his boldness in committing to change a political order that for over 30 years has enabled the Liberal Democratic Party to maintain a firm grip on power. One might wonder why a government leader, particularly one who lacks a solid base of support within his own party, would risk jeopardizing his tenure by trying to overhaul the very political establishment that put him in power. Mr. Kaifu's motivation, in part, may stem from his political background; his mentor, former Prime Minister Takeo Miki, was an early champion of political reform. However, the prime minister's commitment to changing the electoral system appears to have as much, if not more, to do with the unusual circumstances that propelled him to the top leadership position.

Mr. Kaifu, a former education minister and member of a small faction headed by Toshio Komoto, was tapped by ruling party elders in August 1989 to become LDP president and, thus, prime minister in the wake of the LDP's severe trouncing in the previous month's upper house elections and the scandals that forced the successive resignations of Prime Minister Noboru Takeshita and Prime Minister Sosuke Uno within a three-month period. Indicative of the political turmoil brought about by the Recruit Co., Ltd. influence-peddling affair, neither Mr. Uno nor Mr. Kaifu was a faction leader; until then that had been more or less de rigueur for selection as party leader. Mr. Kaifu, who was untainted by Recruit or any other political scandal, served to project the "clean" image that party leaders felt would restore the electorate's confidence in the LDP.

Fertile Ground for Corruption - The Recruit affair highlighted certain aspects of Japan's electoral system that have been fertile soil for corruption throughout the postwar years (see JEI Report No. 10A, March 10, 1989). Specifically, the lower house's multiseat electoral system, wherein three to five candidates are elected to represent each district, requires a candidate to raise extraordinary sums of money to wage what essentially is a personality contest. The money-centered nature of politics in Japan, in turn, has opened the system to abuse over the years in the absence of loophole-proof limits on campaign contributions.

In the Recruit case the parent firm, an information, publishing and job placement conglomerate, had offered between 1984 and 1986 to at least one member of virtually all of the noncommunist parties shares in Recruit Cosmos Co.,

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Ltd. before the real estate subsidiary's stock became available in the over-the-counter market. At that time a company's offering of preflotation shares as a political contribution was neither uncommon nor illegal. However, Recruit's activities gave the appearance of impropriety because of the huge amounts of stock transferred (2 million-plus shares went to approximately 159 people) and the large profits each purchaser realized when the real estate firm went public in 1986. As was later revealed, Hiromasa Ezoe, Recruit's founder and former chairman, strategically targeted these campaign "gifts" in an effort to buy political influence.

A number of senior LDP members were prominent recipients of Recruit Cosmos shares. Those who held cabinet or party leadership positions were forced to resign due to the public outcry over what appeared to be the politicians' greed. The Recruit affair sorely offended Japanese voters' sense of what is just and fair, political commentators maintained. The public, therefore, used the July 1989 upper house elections plus certain prefectural contests to register its distaste for "money politics" -- as exercised by the ruling party in particular -- as well as its opposition to certain LDP-led government policies (see JEI Report No. 32A, August 18, 1989).

Time for Change - The LDP reached a turning point when then Prime Minister Uno was forced to resign in August 1989 to accept responsibility for the ruling party's unprecedented loss of its upper house majority -- which also reflected voter aversion to politically damaging allegations of Mr. Uno's affair with a geisha. The leadership realized that to recoup its losses the ruling party would have to convince the electorate that it was committed to changing its ways. A member of the old guard could not do this if he had been tainted by Mr. Ezoe's aggressive gift-giving strategy.

Mr. Kaifu, a respected politician who had had no dealings with Recruit or alleged liaisons with geishas, thus was plucked from the ranks to lead the party and the nation. At 59 years of age the former education minister also projected a comparatively youthful image that, LDP leaders hoped, would counter opposition party charges that the LDP had become a corrupt old boys' club. (The promotion of "madonna" candidates in the Social Democratic Party of Japan's July campaign had served to underscore the contrast with the LDP's stodgier image.) Moreover, Mr. Kaifu's political tutelage under former Prime Minister Miki made him a credible advocate for changing the business of politics.

What tends to be forgotten, however, is that even before the upper house debacle, the LDP, in an effort to contain damage to the party as a result of the snowballing Recruit scandal, had committed itself to changing the electoral system. Then Prime Minister Takeshita in his New Year's message vowed to make 1989 the year for political reform. He convened a special nongovernmental advisory panel, the Election System Council, to recommend changes to the Public Offices Election Law and the Political Funds Control Law -- the two principal statutes governing campaigning and political fund-raising -- and generally to develop a reform blueprint. Within the ruling party two other bodies were formed to help build a party consensus and develop implementing legislation based on the Election System Council's recommendations. The LDP's Political Reform Headquarters was chaired by avowed reformer Masayoshi Ito; its Research Commission on the Election System was headed by Tsutomu Hata, an up-and-coming Takeshita faction member.

In convening these groups Mr. Takeshita indicated that chief among the possible reforms that might be implemented was a single-seat constituency system to take the place of the multiseat approach. In addition to eliminating wasteful intraparty contests, the single-seat system could help restore some transparency to political fund-raising if central party executives, rather than individual politicians, were in charge of collecting and accounting for the funds, single-seat proponents have emphasized.

Mr. Takeshita may have compounded the LDP's image problem, however, by commenting in a December 1988 news conference that a single-seat system probably could not be implemented "much before the 21st century." In reality this assessment may be sound even today in light of objections from members of both the ruling and the opposition parties. Spoken against the backdrop of the still evolving Recruit influence-peddling scandal, however, the former prime minister's remarks gave the public another reason to question the ruling party's sincerity about abandoning its money-centered approach to politics. Domestic outcry over the Recruit affair only worsened in the ensuing months. By April Mr. Takeshita had little choice but to say he would resign to accept responsibility for the extent of his party's involvement with Mr. Ezoe's company. He formally stepped down in June when party faction leaders agreed to Mr. Uno as his successor.

Kaifu Seizes Political Reform - Soon after winning election to a full two-year term as LDP president in October 1989 (which is when Mr. Takeshita's term would have ended had he stayed in office) Mr. Kaifu declared that reforming Japan's easily corruptible political system would be one of his administration's main goals. He set November 1990 as a target to implement changes; the date corresponded with the 100th anniversary of the Diet.

Most LDP members threw their support behind the new prime minister even though an overhaul of the electoral system probably would mean seat losses for both their party as well as the opposition parties. More important in the short term, ruling party politicians felt, was that the electorate's faith in the LDP's ability to govern be restored before elections for the lower house, regarded as the more powerful of the two Diet chambers. And if that meant rallying around the principle of political reform, that is what they would do. Implementing change was another matter entirely. The unspoken understanding among LDP members was that the negotiating and the dealing typical of most any democratic government's efforts to change its electoral system would occur after the ruling party secured a stable majority in the lower house.

Fitfull Starts and Pitfalls for Political Reform

The Election System Council issued separate reports in 1990 outlining proposed changes for the Diet's lower and upper houses. Its April report has served as the baseline for the LDP's consideration of legislation to implement specific changes in the lower house. Perhaps the most important of the council's proposed reforms was the call to reduce the number of seats in the House of Representatives from 512 to 501. Of these, 301 would be single-seat districts; the remainder would be determined by proportional representation. Thus, each voter would cast two ballots: one for a representative to fill the seat allotted under the single-seat apportionment, the other for a political party. The "proportional" seats would be distributed among the parties according to the number of votes each received in a particular electoral region. The representative would be whoever topped the cutoff figure on the parties' lists of potential delegates. (This is similar to the current setup for upper house proportional seats.) The panel, however, did not suggest how to divide the country into single-seat constituencies or electoral regions.

The Election System Council maintained that these changes would promote elections based primarily on policy differences among political parties and candidates. They also would obviate the need for expensive personality contests -- at least at the district, if not at the party, level. Political reform advocates have emphasized that changes of this nature would facilitate the transfer of power from one party to another, a key to ensuring a healthier, more responsive political system.[1]

To discourage individuals like Mr. Ezoe from trying to curry favor with members of the party in power -- as well as to rein in politicians who feel the need for bulging campaign chests -- the advisory body also proposed changes to the Political Funds Control Law, which regulates fund-raising. Current law stipulates that a politician must make public the names of contributors who give more than Y1 million ($7,400 at Y135=$1.00) to his or her support organization. Politicians have evaded this requirement by setting up numerous political organizations to absorb donations. Thus, the council recommended that politicians be limited to two fund-raising organizations that would not be required to report the names of contributors of Y1 million ($7,400) and less. If a politician has more than two fund-raising groups, then each of the additional groups would be required to report the names of whoever gave more than Y10,000 ($74). The Election System Council also recommended that parties that garner 1 percent of the votes cast in lower house elections be eligible to receive state subsidies to help defray campaign costs. Currently the government extends no campaign assistance to candidates.

The council's second report in July 1990 focused on how to reform the election process for the upper house, which already features a mix of single seats and proportional representation. Specifically, the group of predominantly private-sector advisers recommended that constituents be allowed to vote either for an individual candidate or for a party when electing the 100 proportional representatives. Under the reform plan winning candidates would be determined on the basis of the number of votes they actually garner, but the votes for their parties would be aggregated to determine how many of a party's candidates succeeded. Now voters cast ballots for a party, which selects winning candidates based on their position on the party's prioritized list.

Concerning the constituencies from which the remaining 152 upper house councillors would be elected, the panel suggested that the number of seats be maintained at the present level but that they be allocated according to population. Some prefectures currently are overrepresented in the House of Councillors. The advisory group proposed that, as a first step, each prefecture be given two upper house seats, with the rest distributed according to population.

While the Election System Council's analysis of the situation in the upper house was awaited anxiously by potentially affected individuals, the lower house plan generally has been of greater interest and concern to politicians and the public because this chamber is more powerful. The House of Representatives selects the prime minister, approves treaties and has the final say on the budget. Upper house activity is not unimportant; concurrence from the House of Councillors is required to enact all nonmonetary legislation. The opposition parties, in fact, have used their unprecedented strength in this chamber since July 1989 to force ruling party concessions on certain issues. The public perception, however, is that the multiseat formula for election to the lower house over the years has spawned corruption and abuses of power; thus, this house should be the initial focus of reform efforts.

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[1] Takeshi Sakaki, "Postwar Japanese Politics At A Turning Point," The Japan Foundation Newsletter, XVIII, Nos. 5-6, May 1991.

LDP Panels Make Suggestions - With the hourglass quickly draining as Mr. Kaifu's November 1990 deadline neared for enactment of electoral reform legislation, the two LDP-appointed reform panels -- Mr. Ito's Political Reform Headquarters and Mr. Hata's Research Commission on the Election System -- unveiled a draft package of measures. Not all the recommendations outlined at the late November 1990 joint meeting paralleled those proposed by the Election System Council; some were more drastic, others less so. Under the ruling party's first draft the number of lower house seats would be cut from 512 to 471, compared to the council's proposed reduction to 501. Three hundred of the lower house's proposed 471 members would be elected from single-seat constituencies, the LDP report suggested, with the other 171 elected according to proportional representation.

The two LDP panels adopted several of the Election System Council's proposals on campaign financing and fund-raising. For example, both concurred that the government should help underwrite campaign expenses and that this money should be distributed to parties based on a formula that takes into account the number of each party's members elected to a Diet house in the previous election as well as the number of votes garnered by each party. While also recommending that the number of political support organizations be curtailed to two for each politician, the LDP committees stopped short of proposing that politicians make public the amount of money collected through these two support bodies. Moreover, in an effort to close the door to further Recruit-type excesses, the LDP draft recommended that any one individual or employee of a business should not be allowed to contribute more than Y1 million ($7,400) at a time through the purchase of political fund-raising tickets. The ruling party panels also said that political organizations should be required to make public at the end of a year documents detailing acquisitions of land, stocks, loans or other assets exceeding Y1 million ($7,400).

Not surprisingly, Mr. Kaifu's deadline for political reform came and went with no Diet action. Despite the LDP panels' best efforts to develop an enactable plan, the November 1990 draft drew such strong criticism from ruling and opposition party members alike that the prime minister never even submitted the plan to the Diet.

Dissension More Pronounced - The opposition parties charged that the reform package drawn up by the LDP panels overwhelmingly favored the ruling party. In its April report the Election System Council had estimated that nearly 97 percent of its proposed lower house single-seat constituencies would be won by the LDP. And while the council had proposed that 60 percent of the House of Representatives members be elected from single-seat districts, the ruling party panels expanded this to about 64 percent. Thus, the opposition parties argued, the LDP's plan would assure the ruling party of a landslide victory, while the Social Democratic Party of Japan, Komeito and the Japan Communist Party would suffer sizable losses. Moreover, small parties, such as the 24-member Democratic Socialist Party, and single-issue parties would disappear, opposition party politicians contended.

Prime Minister Kaifu also faced dissension within the LDP; as of late last year a reported one-quarter of the ruling party's Diet members objected to the LDP reform plan. Some LDP politicians felt constrained by the proposed restrictions on campaign contributions. The move away from the multiseat system, however, drew the most fire since some electoral districts would be eliminated. Junior LDP members also were concerned that they would be told to run for a proportional seat or in a district where they had no political base. In addition, there was uncertainty as to whether or when a member would be designated an "official party candidate" and if an abundance of money still would be needed, either to campaign to be named a proportional candidate or to campaign for a single seat.

International Troubles Intrude - At about the same time Mr. Kaifu had other controversial issues to get through the Diet, principally how Japan should support the allied forces fighting in the Persian Gulf War. Hampered by his weak domestic base, the prime minister simply did not have the political capital or influence to both galvanize support for a bold new foreign policy initiative and tackle a major overhaul of the electoral system.

In early November before the LDP draft reform plan was released Mr. Kaifu found himself in a predicament. He either could withdraw from the Diet a bill that would have authorized the establishment of an unarmed team of civilian and military personnel to support United Nations-sponsored peacekeeping activities or he could suffer the political humiliation of the bill's defeat. He took the former course, but the withdrawal of the measure was viewed in many LDP circles as just as indicative of the prime minister's political weakness as its trouncing by a Diet vote would have been (see JEI Report No. 44B, November 16, 1990).

Coming on the heels of this contretemps, the sharp attack that greeted the LDP panels' draft reform proposal resulted in the prime minister quickly setting priorities. Political reform was relegated to the back burner, as Mr. Kaifu decided to focus his administration's efforts on developing support within the Diet for a $9 billion contribution to aid allied coalition efforts in the Persian Gulf and, thus, try to appease escalating international criticism that Japan was shirking its responsibilities as a global power (see JEI Report No. 6A, February 15, 1991). Since Mr. Kaifu had staked his political life on electoral reform, highly politicized debates on the issue did not seem a good idea when he was trying to guide Japanese foreign policy in a new direction.

Countdown to Enactment - The end of the gulf war and the conclusion of the 120th regular Diet session, during which legislators enacted three budget bills and a number of other important measures (see JEI Report No. 19B, May 17, 1991), meant that if Mr. Kaifu wanted to push for passage of the political reform plan he would have to call a special session of the Diet. Not long after adjournment the prime minister indicated that he would convene an extraordinary Diet session in late July for the express purpose of considering the political reform package as well as a revised version of the U.N. peace cooperation team legislation.

Senior LDP officials immediately raised roadblocks against the plan to proceed with political reform. LDP secretary general Keizo Obuchi and Policy Affairs Research Council chairman Mutsuki Kato argued that more discussions were needed between top ruling party officials and the two LDP electoral reform panels. Mr. Kaifu, however, insisted that an outline of the bill should be written before the end of June when the terms of the members of the Election System Council were set to expire. The council's continued existence was considered necessary to help draw up maps of single-seat and regional constituencies for the lower house. Such a short time frame, Mr. Kato stressed, was insufficient to draft both the outline of the bill and voting districts.

Mr. Kato's concerns apparently did not sway the prime minister. In a virtual repeat of the November joint meeting of the Political Reform Headquarters and the Research Commission on the Election System, the LDP Executive Council approved at the end of May a draft bill to revamp Japan's political system; for the most part the plan resembled the one that was advanced by the two LDP groups. Mr. Kaifu then instructed Home Affairs Minister Akira Fukita to develop implementing legislation by the end of June. The prime minister followed this up with an early June request to the Election System Council to draw the all-important districting lines in accordance with the ruling party's proposal. Noting the differences between the council's April 1990 proposal and the LDP-approved plan, Mr. Kaifu urged the advisory panel to stick to the ruling party's plan.

The LDP Executive Council's draft appeared to draw as much criticism on all fronts as had its predecessor. To build an interparty consensus on the issue Mr. Obuchi has sought to establish a consultative body of ruling and opposition party representatives. Mr. Kaifu, too, has expressed willingness to meet with senior opposition party officials to promote a more cooperative atmosphere. Support is necessary at the very least from Komeito, which holds the swing votes in the upper house.

Perhaps as challenging as winning opposition party support will be forging a consensus within the ruling party. Mr. Kaifu lost an invaluable reform ally in April when Ichiro Ozawa resigned as party secretary general to assume responsibility for a failed electoral strategy in the Tokyo gubernatorial election (see JEI Report No. 14B, April 12, 1991). Mr. Ozawa last year had pledged his "unreversible resolve" to secure enactment of political reform legislation. With his popularity and political influence he stood a good chance of realizing this goal.

Business Support - The business community recently threw its weight behind political reform, which may, or may not, help the prime minister solidify LDP support for the legislation. Five major business organizations -- Keidanren (Japan Federation of Economic Organizations), Nikkeiren (Japan Federation of Employers' Associations), the Japan Chamber of Commerce and Industry, Keizai Doyukai (Japan Association of Corporate Executives) and Kankeiren (Kansai Economic Federation) -- issued a joint statement in the first part of June calling for early realization of political reform. Speaking on behalf of the groups, Gaishi Hiraiwa, chairman of Keidanren, told Mr. Kaifu that the business community views enactment of electoral reform as its "greatest concern" and that the prime minister had their backing on this issue.

The private sector apparently is concerned that dissension within the LDP will cause paralysis on this issue. The early June statement was at least the third time business leaders had called for implementation of political reform. Corporate representatives want these changes in part to alleviate the financial burdens they must shoulder in the form of political donations. "Firms must inevitably extend a certain amount of financial support to politicians as the cost of maintaining democracy in our society," Masaya Miyoshi, director general of Keidanren, stated. He added that election and other political expenses should be shared equally among the government, the parties and support groups, of which businesses are members.

Political Ambitions Threaten Kaifu and Political Reform

When the extraordinary Diet session convenes this summer Mr. Kaifu will face virtually the same politically impossible agenda that nearly was his undoing in November: political reform and Japanese participation in U.N.-sponsored peacekeeping activities. Last year he was able to postpone action on one initiative to try to salvage the other; now, four months before his term expires, Mr. Kaifu's political survival is tied closely to electoral reform. He is pushing for action at a time when the political attractiveness of this issue is waning within the LDP. The way many ruling party members see it, the LDP's resounding victories in the February 1990 lower house contests as well as in local assembly and gubernatorial elections this past April indicate that the electorate is willing to forgive the ruling party for the Recruit affair. Thus, in addition to LDP members' concerns about the fund-raising constraints and turf losses that would come with enacting systemic reforms, many simply feel that the ruling party no longer needs to demonstrate its willingness to change its ways.

Mr. Kaifu also is pushing this initiative against an increasingly hostile political backdrop. Ruling party doyens, who selected the politically "clean" former education minister as a stopgap leader to help restore the public's confidence in the LDP, feel Mr. Kaifu has served his purpose. While other faction leaders' designs on the top position have been apparent since early in the prime minister's term (see JEI Report No. 12A, March 23, 1990), maneuvering accelerated this spring.

Party Restiveness - Mr. Ozawa's resignation, for all intents and purposes, has set Mr. Kaifu adrift by cutting his ties with the powerful Takeshita faction, of which the former LDP secretary general is a member. Many analysts say that Mr. Ozawa's association with this group as well as his political savvy and leadership acumen enabled the Kaifu administration to secure enactment of gulf war-related financing legislation and other sensitive measures that required building a coalition with the DSP and Komeito. There is a view that Mr. Ozawa resigned as a means of distancing himself from the stopgap leader. Once a successor to Mr. Kaifu enters office, continues this line of thinking, the former number-two party official would be in a position to hold prestigious cabinet posts as part of a long-term strategy to win election to the top leadership slot.

The LDP ethics committee's late April decision to approve ex-Prime Minister Yasuhiro Nakasone's application to reenter the party (he resigned in 1989 because of his involvement with Recruit) also added a new twist to leadership maneuvering. This action, reportedly orchestrated by Mr. Takeshita, in effect has cleared the way for the reemergence of Recruit-tainted ruling party leaders, including both Mr. Takeshita and Mr. Nakasone as well as former Finance Minister Kiichi Miyazawa and LDP faction chief Michio Watanabe.

These party doyens, who have adhered patiently to the LDP's arcane seniority rules in selecting prime ministers, apparently are worried about restive, younger members, such as Messrs. Ozawa and Hata, who also want a shot at the premiership in the near future. Mr. Kaifu's selection as prime minister upset the normal hierarchical system; it also gave Mr. Ozawa and others hope that they, too, could capitalize on this important break from the past. Mr. Takeshita and his contemporaries feel, however, that the October LDP presidential election offers them a chance to reimpose the party's seniority rules and perhaps to grab the brass ring. The former prime minister, in particular, is said to resent the fact that he was forced to leave his post prematurely due to the Recruit scandal. Although in Japan's postwar political history a former prime minister has never won reelection after having been out of office for a period, Mr. Takeshita appears to have his sights set on breaking tradition.

Openings for Change - The mid-May death after a prolonged illness of former Foreign Minister Shintaro Abe intensified intra-LDP competition to seize the leadership mantle from Mr. Kaifu. Mr. Abe had played a critical behind-the-scenes role in the 1987 selection of Mr. Takeshita as LDP president and, in turn, prime minister. Although Mr. Takeshita had enjoyed the backing of the previous prime minister, Mr. Nakasone, the backroom negotiations characteristic of the LDP leadership selection process included at least one tacit agreement that when Mr. Takeshita left office the leadership baton would go to Mr. Abe in return for the latter's support. The Recruit affair upset this succession, but many ruling party members viewed Mr. Abe as the next in line to succeed Mr. Kaifu. His death, therefore, opened up the contest.

The Takeshita faction wasted little time and indicated the day after Mr. Abe's death that it would not endorse Mr. Kaifu to continue as LDP president after his term expired at the end of October. Some political commentators have suggested that the faction's quick response was designed to achieve two objectives: first, to give Mr. Kaifu a clear signal that he cannot stay in power past October; and second, to restrain moves by other factions. By declaring that it would field a candidate of its own in the next LDP election, the Takeshita faction signaled its intention to support the Kaifu administration until this fall.[2]

In one of the peculiar twists of Japanese politics, however, the man who has been the nominal head of the group since Mr. Takeshita removed himself from the helm following the Recruit affair, Shin Kanemaru, has indicated that the group plans to field either Mr. Ozawa, Mr. Hata or Finance Minister Ryutaro Hashimoto -- members of the LDP "younger generation." Underscoring reports of a falling out between Mr. Kanemaru and Mr. Takeshita is the conflict between Mr. Kanemaru wanting to elevate younger, talented faction members to the premiership -- namely, Mr. Ozawa -- and Mr. Takeshita wanting to retain the option of once again taking the reins of government. This has left the faction that bears the former prime minister's name racked with infighting. Mr. Kanemaru and the former LDP secretary general reportedly are worried that Mr. Kaifu may choose to resign prior to October -- if the political reform initiative fails, for example. Many political observers say that Mr. Kaifu owes his current position to Mr. Takeshita's support in particular. Thus, it would not be unreasonable for Mr. Kaifu to consider stepping down at a time seen as favorable for Mr. Takeshita.

[2] Toshiharu Ando, "Kaifu Appears Positioned To Fill Out Term," Nikkei Weekly, June 1, 1991.

Mr. Abe's death could have an even greater influence on factional politics by precipitating a wholesale realignment of the ruling party's groups. It still is unclear what will become of the Abe faction. Former Foreign Minister Hiroshi Mitsuzuka, who also was head of the Ministry of International Trade and Industry under Mr. Takeshita, assumed leadership the third week of June. Political analysts are skeptical, however, that the Abe group can remain united. Given Mr. Takeshita's close relationship with the late faction chief, the former prime minister no doubt will try to co-opt members of the Abe faction, particularly since his own group is no longer close-knit.

If the Abe group splits or disbands, some observers speculate, the ruling party's equilibrium may be disrupted. Younger members, like Messrs. Ozawa, Hashimoto and/or Hata, might view the disintegration of this faction as an opportunity to break away from the Takeshita group and form their own power centers, possibly drawing support from former Abe allies.

It would appear that the drama of LDP factional politics may not play to Mr. Kaifu's advantage. The outlook for the prime minister, the Abe faction and the ruling party in general will become clearer as the summer unfolds. Some analysts have suggested that as long as Mr. Kaifu can keep the Diet debate focused on political reform it will be harder for Recruit-tainted members to engage in precisely the sort of wheeling, dealing and self-promotion that rankled the electorate in July 1989 into voting against returning a LDP majority to the upper house.[3] However, the prime minister's political weakness may make it hard for him to even convene the special session, let alone orchestrate debate on an issue that does not enjoy broad support.

Socialists Grapple With Their Own Reform Needs

When the Social Democratic Party of Japan convenes a special two-day session in early July its members will have more pressing matters on their agendas than the LDP's plan to reform the political system, even though the plan clearly would hurt the SDPJ. For one, forming a strategy to undermine enactment of the reforms would not be too difficult to develop and carry out. The Socialists simply would have to work with the other opposition parties, which face potentially greater losses than the SDPJ does under the LDP plan, and use the majority they enjoy in the Diet's upper house to block passage of the legislation. Even if the LDP is able to get the reform legislation through the lower house, it would have to build a bridge to Komeito to get the bill passed by the upper chamber. At this stage that scenario appears problematic due to Komeito's stated opposition to political reform as well as the prime minister's political problems. Most commentators expect that the opposition parties will use their upper house majority to fight the reform initiative.

What appears to be of greater concern to SDPJ members is the outlook for their own party. After weeks of speculation SDPJ chairperson Takako Doi announced the third week of June that she was resigning as the party's standard-bearer to take responsibility for the Socialists' trouncing in recent local elections. Although the SDPJ realized unprecedented gains in the July 1989 upper house elections, the party has been unable to match this performance at the polls since that time.

[3] Itaru Oishi, "Reform Issue Falls Victim To Faction Expediency," Japan Economic Journal, April 27, 1991.

In last year's February elections for the 512-seat House of Representatives the SDPJ picked up 58 new seats, increasing its tally there to 141 from 83. However, the Socialists did not realize the gains they had hoped; in at least 36 races considered to be close, for example, the ruling party candidate edged out the SDPJ competitor. In addition, the seats won were at the expense of other opposition parties. Analysts have attributed this less than stellar outcome to a number of factors that previously had limited the Socialist Party's political influence and hampered its ability to mount an effective challenge to the LDP: poor electoral strategy, lack of policy coherence, ideological fuzziness and internal divisiveness (see JEI Report No. 12A, March 23, 1990).

Last April's local elections, in which the SDPJ failed to garner even 10 percent of the Tokyo gubernatorial vote and lost 98 prefectural assembly seats, drove home to the party leadership as well as the rank and file the need for change (see JEI Report No. 14B, April 12, 1991). The Socialists realized that they had not conveyed to the electorate a vision of how the SDPJ could lead the country better than the LDP on the broad range of political and economic issues confronting the country.

Ms. Doi, although still a charismatic figure in Japanese politics, was singled out by her colleagues for attack. Many SDPJ members apparently felt that the former constitutional law professor should be removed from the helm because the views she espoused were out of touch with Japan's conservative, prosperity-oriented middle class. As a member of the party's left wing, Ms. Doi tended to exhort an ideology rooted in Marxism. More conservative SDPJ members point out that the average Japanese no doubt sees the moves in Eastern Europe and the Soviet Union away from the teachings of Karl Marx and wonders what relevance similar theories could have to current political and economic conditions in Japan or anywhere else.

At the July convention the Socialists are expected to review ways in which they might adapt their platform to new domestic and international conditions. In a late May speech before the annual meeting of the Japan America Society of Chicago Ms. Doi acknowledged that the SDPJ's political "soul-searching" process could be arduous. She explained that the diversity within the party will complicate debates concerning its future direction. "The Socialist Party is not monolithic," she stated. "It is a diversified political party encompassing a wide range of political persuasion, from those who are close to the Liberal Democrats on the right to those who are close to the Communists on the left . . . it takes a great deal of patience to formulate a consensus from all these different views."

Outside observers concur, pointing out that when Ms. Doi was elected party chairperson in 1986 SDPJ members selected Tsuruo Yamaguchi, who is right of center, as secretary general to balance the leadership.[4] Analysts also emphasize, however, that the Socialist Party, despite talk of unity, has yet to pull together. One reason why the opposition parties have been unable to develop a more formal coalition to challenge the ruling party is because of the stubborn, diverse elements within the SDPJ.

[4] Itaru Oishi, "Left, Right Wings Gird To Battle SDP Helm," Japan Economic Journal, April 25, 1991.

With the ruling party increasingly developing closer ties with Komeito and the DSP -- effectively isolating the Socialist Party and exacerbating its efforts to build an opposition coalition -- SDPJ members certainly have an incentive at their July conference to put differences aside and adopt a platform that is more appealing to the electorate. The question is whether the party's desire to lead the country is sufficient to force acceptance of some difficult changes by its disparate membership. The SDPJ's efforts to date to transform itself into a "ruling party" suggest that its years as the "permanent opposition" may have what some analysts have termed an enervating impact on the Socialists.[5]

Outlook

The Recruit affair highlighted problems in Japan's electoral system and loopholes in its fund-raising laws. The conventional wisdom following the July 1989 upper house elections was that both the system and the business of politics in Japan had to be changed for the LDP to maintain its grip on power. Some analysts felt that the SDPJ's gains in the February 1990 lower house contests, although not as impressive as in the House of Councillors, nevertheless represented the public's view that the LDP should be reined in a bit more.[6] Some questioned whether there was hope for even broader change that would lead to a viable two-party system.

The ruling party's successes at the polls since that time as well as its rising support ratings have lessened LDP members' urgency to rectify systemic problems as a means of making amends with the public. Virtually every politician from every party has some vested interest in maintaining the current electoral system, particularly in the lower house. At the same time politically ambitious LDP members are growing restive and want a change at the top.

Even a politically strong prime minister might be daunted by trying to enact a comprehensive overhaul of the electoral system against this backdrop. Mr. Kaifu, who owes his seat of power to an unusual series of events, probably will not be successful in enacting political reform on his own. Although the prime minister might be able to get this legislation through the lower house with the support of some of the major faction heads, that support may not be there to help him build the LDP-opposition coalition necessary to secure passage in the upper chamber. LDP faction leaders, in fact, might predicate their assistance on political reform on Mr. Kaifu's agreeing to remove himself from the leadership race in October and throwing his support behind one or the other factions' choices.

With political reform, one observer noted, the ruling party has a chance to "[pave the way] out of the narrowness and shallowness of the present and toward a new politics of breadth and depth."[7] In view of the behind-the-scenes maneuvering to seize the reins from Mr. Kaifu, it would appear that LDP members would rather revert to the pre-Recruit days than change the way they conduct the business of politics. The SDPJ appears even less willing and able to transform itself. The summer months hold the potential for important political changes, but reaction so far in Japan appears to be treating that potential as a mirage.

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[5] Gerry Curtis, The Japanese Way of Politics (New York, New York: Columbia University Press, 1988), p. 123.

[6] Yukio Suzuki, "Perceptions Must Change," The Japan Times, March 6, 1990.

[7] Sakaki, op. cit.

For further information, contact Barbara Wanner.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Upper House Party Alignment, June 1991

Party	Seats
Liberal Democratic Party	114
Social Democratic Party of Japan	73
Komeito	20
Japan Communist Party	14
Rengo	12
Democratic Socialist Party	10
Minor Parties	4
Independents	4
Total	251

Note: One seat is vacant.

Lower House Party Alignment, June 1991

Party	Seats
Liberal Democratic Party	279
Social Democratic Party of Japan	139
Komeito	46
Japan Communist Party	16
Democratic Socialist Party	14
Rengo	0
Minor Parties	5
Independents	5
Total	504

Note: Eight seats are vacant.

Liberal Democratic Party Factions

	Lower House	Upper House	Total
Noboru Takeshita*	69	37	106
Shintaro Abe	64	26	90
Kiichi Miyazawa	62	20	82
Michio Watanabe	50	20	70
Toshio Komoto	24	7	31
Independent	10	4	14
Total	279	114	393

*To accept responsibility for the involvement of some LDP members in the Recruit Co., Ltd. bribery scandal, Noboru Takeshita resigned in the spring of 1989 as prime minister and LDP president. At this time he also stepped down as head of his faction, although it still bears his name. Shin Kanemaru now leads the Takeshita faction.

Source: Japan Economic Journal, May 25, 1991.

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JEI

REPORT

A Two-Part Report: A and B

NO. 24B
June 28, 1991

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Japan's GNP Jumps In 1991's First Quarter

In early 1973 the Japanese economy was in the final stages of what now is known as its period of rapid growth. In the first quarter of 1973 the real gross national product was up 3.2 percent over the October-December 1972 period. Within months the first oil shock would hit and prices would spiral temporarily out of control. Since then Japan's economy never has shown the sustained growth it experienced during nearly two decades up to 1973.

Fast forward to the first quarter of 1991. The Japanese economy grew an inflation-adjusted 2.7 percent for the three-month period or 11.2 percent on an annualized basis, the fastest quarterly pace of expansion since that period exactly 18 years ago (see Table). This apparently vibrant performance was all the more remarkable because most analysts believed that the Japanese economy was sluggish at best; a few even had hinted that Japan was in a recession. Given the international context, where nations such as the United States had to endure a shrinking GNP over the same period, any growth at all would have been a good performance.

STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1989	1990	January-March 1990	January-March 1991	January 1991	February 1991	March 1991
Japan's Balance of Payments							
Trade Balance	$76,917	$63,528	$14,393	$20,383*	$3,010*	$6,885*	$10,488*
Exports (f.o.b.)	269,570	280,374	65,460	74,886*	21,523*	24,293*	29,070*
Imports (f.o.b.)	192,653	216,846	51,067	54,503*	18,513*	17,408*	18,582*
Current Account Balance	57,157	35,761	12,305	10,360*	-33*	6,085*	4,308*
Long-Term Capital (net)	-89,246	-43,586	-16,086	10,612*	-2,936*	5,962*	7,586*
Overall Balance	-33,286	-7,234	-66	8,129	-5,237	8,585	4,781
International Reserves (end of period)	84,895	77,053	73,496	69,894	77,520	77,974	69,894
Japan's Customs Clearance Trade							
Trade Balance	64,328	52,149	12,322	14,564	948	5,088	8,528
Exports (f.o.b.)	275,175	286,948	66,705	76,384	21,831	24,988	29,565
Cars	38,804	41,348	10,545	11,801	3,827	3,889	4,085
Steel	14,789	12,509	2,912	3,191	934	1,010	1,247
Imports (c.i.f.)	210,847	234,799	54,383	61,820	20,883	19,900	21,037
Crude Oil	21,544	31,584	6,917	10,595	3,407	3,170	4,019
Manufactured Products	106,111	118,028	27,228	29,427	10,035	9,760	9,633
Japan-U.S. Trade							
Trade Balance	44,943	37,954	8,908	9,077	2,397	2,863	3,817
Exports (f.o.b.)	93,189	90,322	21,661	22,325	6,671	7,416	8,237
Imports (c.i.f.)	48,246	52,369	12,754	13,247	4,274	4,553	4,421
Yen-Dollar Exchange Rate (average for period)	Y137.96	Y144.79	Y147.90	Y133.85	Y133.88	Y130.48	Y137.20
U.S. Trade							
Trade Balance	-109,399	-101,009	-22,150	-13,223	-7,017	-4,333	-1,873
Exports (f.a.s.)	363,812	393,894	97,372	102,630	33,150	32,683	36,797
Imports (Customs)	473,211	494,903	119,522	115,853	40,167	37,016	38,670
U.S.-Japan Trade							
Trade Balance	-49,059	-41,071	-9,602	-10,196	-3,462	-3,159	-3,575
Exports (f.a.s.)	44,494	48,585	11,963	12,323	3,820	4,263	4,241
Imports (Customs)	93,553	89,655	21,565	22,519	7,281	7,422	7,816

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1989	1990	January-March 1990	January-March 1991	January 1991	February 1991	March 1991
Discount Rate (end of period)	4.25%	6.0%	5.25%	6.0%	6.0%	6.0%	6.0%
Outstanding Money Supply	9.9%	11.7%	11.7%	6.0%	7.4%	5.5%	5.1%
Industrial Production	6.1%	4.6%	1.8%	5.9%	7.8%	6.7%	3.5%
Manufacturing Operating Rate	2.2%	2.3%	0.4%	2.1%	4.6%	2.1%	-0.4%
Number of Bankruptcies	-28.5%	-10.6%	-29.3%	49.0%	41.8%	51.1%	53.8%
Residential Construction Starts	-1.3%	2.7%	2.9%	-11.4%	-4.2%	-12.5%	-16.3%
Job Openings to Applications (ratio)	1.26	1.40	1.35	1.46	1.44	1.46	1.47
Nominal Wages	4.1%	4.7%	4.4%	3.3%	0.5%	4.9%	4.8%
Manufacturing Labor Productivity	6.2%	4.2%	2.6%*	7.5%*	7.5%	n.a.	n.a.
Wholesale Prices	2.5%	2.0%	3.7%	1.6%	2.1%	1.6%	1.0%
Consumer Prices	2.3%	3.1%	3.4%	4.1%	4.5%	3.9%	4.0%
Yen-Based Export Prices	4.4%	2.1%	6.6%	-4.0%	-3.1%	-4.4%	-4.6%
Yen-Based Import Prices	7.7%	8.6%	12.9%	1.1%	8.1%	0.9%	-5.5%

*Through January of each year only.

For Japan's latest GNP figures, see JEI Report No. 24B, June 28, 1991.

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JEI

REPORT

A Two-Part Report: A and B

NO. 25A July 5, 1991

JAPANESE HEALTH-CARE SYSTEM NO PANACEA FOR AILING U.S. PROGRAM

Summary

The litany of what works with the Japanese health care system— could make Americans sick with envy, if viewed only superficially. The Japanese have apparent good health, as judged by longevity and infant mortality rates. Plus, the increase in national expenditures for medical care in recent years has been within several percentage points of economic growth rates. That contrasts with the double-digit rise in national medical expenses in this country. Moreover, Japan's system of health insurance covers almost all its citizens, while a woeful 35 million or so Americans have neither private nor government insurance coverage.

Access, affordability and, by extension, cost containment are key components in plans being drafted to help make America's health statistics rosier for a greater number of people. Adequacy, too, is important since access is not likely to be attained at the loss of technology. A closer look at the Japanese system points to problems in some areas and incompatibilities in others for those who might be seeking a model. Questions about who pays for health care as well as insurance, how cost containment is approached, the role of income equity and underlying attitudes toward medical care offer insights into the Japanese system's strengths and weaknesses.

Seeking a Cure for System Deficiencies

When America's health system performs well, it performs very, very well -- at a cost. But for those 33 to 35 million Americans who have no health insurance or the infants who have a better chance of early life survival in some developing countries than they do in U.S. inner cities, the system is patently insufficient. Heard more and more in America are two questions: What is this country getting when it spends more of its gross national product on medical care than any other leading industrialized nation -- 12.2 percent in 1990 compared with 11.6 percent the year before -- and who is not benefiting. In fiscal year 1989, which ended March 31, 1990, Japan spent 4.9 percent of its GNP on health care. Life expectancy that year in Japan was the world's highest at 81.8 years for women and 75.9 for men. Its infant mortality rate is one of the world's lowest. And access to health care is nearly universal.

These few indicators do not necessarily make Japan a logical model as U.S. policymakers set about to draft improvements in America's health system. Since every country has its particular concerns and approaches to health services as well as financing methods, system revision cannot merely copy another country's format. Interestingly, however, few domestic proposals for change have drawn on aspects of Japan's system. Those suggesting ways to cure U.S. health-care deficiencies typically have looked at other nations' programs, particularly Canada's and Germany's.[1]

Japan's insurance system has components similar to both and, in fact, planners originally looked to Germany when establishing the country's first employment-based insurance fund. Like Germany's "sickness" funds, Japan's job-related insurance societies provide health coverage to the majority of the population. (For an overview of Japan's health insurance system, see JEI Report No. 16A, April 21, 1989.) For the approximately 36 percent of the population not eligible for some type of work-linked insurance, national health insurance coverage is available through local government programs under central government supervision. This has some similarities to Canada's province-centered programs. Also similar is the element of patient choice of hospitals and personal physicians.

Relatively easy access to care is not, however, a sufficient criteria for Japan serving as a model. Also crucial is affordability, not just as it relates to insurance coverage but to the ability of the system to control overall costs. This also involves adaptability to technological progress and changes in demographics and disease patterns.

[1] Democratic staff members who developed S 1227, HealthAmerica: Affordable Health Care for All Americans Act, have noted that while they studied a broad range of systems, they found elements in Germany's employment-based insurance system and its use of multiple payers to be potentially the most compatible with the existing U.S. system. For a look at various countries' health insurance programs, see Karen Horkitz, International Benefits: Part One -- Health Care, EBRI Issue Brief No. 106 (Washington, D.C.: Employee Benefit Research Institute, September 1990). For comparisons of selected international health systems, see Appendix.

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A Health System That's Relatively Painless

Even if a sick or injured Japanese visitor receives excellent care in an American medical setting, he or she most likely will suffer some confusion over payment. Provided that the patient has insurance coverage of some type, there are several questions, and the responses often vary from doctor's office to doctor's office. Does the insured pay the entire bill and ask for reimbursement from the insurance company? Does he or she ask the doctor to send the entire bill to the insurer and wait to determine how much must be paid out of pocket? Does the patient make an immediate copayment and wait for an insurer to determine how much, if any, of the rest is covered by a deductible and how much remains to be paid? In Japan the payment process is much simpler, as is the insurance component in general.

Copayments, a set percentage, depend on the type of insurance coverage and whether the medical care was for inpatient or outpatient services. Under national health insurance (which includes coverage for farmers, self-employed people and those working in offices with less than five people) the copayment is 30 percent of the outpatient dependent's bill; for most primary (employed) beneficiaries the copayment is only 10 percent of the bill (see Table 1). Those on public assistance pay a percentage, if anything. Senior citizens, aged 70 and older, face charges of at most Y400 ($2.96 at Y135=$1.00) a day for inpatient treatment and Y800 ($5.93) a month for outpatient services. They pay no premiums since 70 percent of the elderly insurance fund comes from contributions made by workers' insurance funds and the national insurance fund; the central government supplies 20 percent and local governments subsidize 10 percent.

Once this copayment has been made, the patient has no more involvement with the bill. (Private insurance claims for semiprivate or private hospital rooms or other items not covered under regular insurance are the patient's responsibility, however.) The medical provider (doctor or hospital) submits the remainder of the claim to a government-run bill examination and payment office, which sends approved claims to the insuring organization (such as the 167 national health insurance associations, 3,429 local governments operating NHI programs, the 1,814 insurance societies, mutual aid associations or the central government's Social Insurance Agency). U.S. studies have estimated that a centralized billing system would reduce overhead costs by between 2 and 13 percent.[2] Not only do U.S. patients suffer from billing confusion but providers here are swamped by the paperwork necessary for myriad, disparate insurers.

Equally straightforward in Japan is the process for obtaining insurance. Although there are some exceptions, every person employed in a business with five or more people must be insured. (Among the exceptions are private employees in the agriculture, forestry and fisheries sector, people who do seasonal labor for less than four consecutive months, those who work at an unfixed location and workers employed on a daily basis or for less than two months. These people are eligible to join the national health insurance system.) If a person works for a company that has set up an insurance entity, enrollment is automatic with that association. Generally, such companies must have more than 300

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[2] Congressional Budget Office, Rising Health Care Costs: Causes, Implications and Strategies (Washington, D.C.: April 1991), p. 50.

Table 1: Estimated Health Care Premiums, Payments and Benefits by Those Under Age 70* at December 1989 Rates

Type of Insurance	Number Enrolled		Premiums	Sample Payments	Benefits		State Subsidy
	Insured	Dependents			Insured	Dependent	
Government-Managed General (28% of coverage)	16,718,804 16,594,829	17,945,707 17,883,707	8.3% of SMR** plus 1% of bonus***; FY 1988 average: Y226,648.	Y19,211/month for typical male worker; Y13,114/month for typical female worker.	90%	80% (inpatient) 70% (outpatient)	16.4% of benefit costs
Day Laborers (0.1% of coverage)	123,975	62,000	Fixed rate varies; split about 60-40; FY 1988 average included above.	Laborer paid a daily wage of Y14,000 would pay about Y545/day, the employer Y885/day.	90%	80% (inpatient) 70% (outpatient)	16.4% of benefit costs
Society-Managed (25.3% of coverage)	13,720,670	17,366,797	3% to 9.5% of SMR plus up to 1% of bonus; FY 1988 average of 8.3% or Y270,599 per worker; usual split 4.15%; employee pays 0.3% of bonus, employer 0.5%.	Y14,933/month for typical male worker paying 4.5% of SMR; typical female worker would pay Y8,353/month at 4.5% of SMR. Worker's share may be nothing, depending on employer. Total premium could hit Y31,525/month for typical male worker (9.5% of SMR).	90%	80% (inpatient) 70% (outpatient)	Y7.75 billion; fixed FY 1989
Mutual Aid Associations (9.8% of coverage)	5,062,000	7,029,000	Average of 8.1% of SMR.	Y24,201/month for federal employee in association (if pays full amount); Y24,832/month for federal employee in federation paying total; Y21,477/month for local government worker paying full amount.	90%	80% (inpatient) 70% (outpatient)	None
National Health Insurance (36.3% of coverage)			FY 1988 per person average: Y57,855.				
Local Governments	40,690,110	n.a.	Determined by local rules but not to top Y420,000/year per household.		70% in general but 80% for retiree and 80% for retiree's dependent as inpatient and 70% as outpatient (retiree must be former member of employee insurance group)		50% of benefit costs
NHI Associations	3,924,089	n.a.	Average: Y57,855/year; fixed by local rules but not to top Y420,000/year per household.				30-50% of benefit costs (none for retiree on NHI)

*Those aged 70 and over plus those aged 65 and bedridden are eligible for Health Insurance for the Elderly, which covers 100 percent of costs with an inpatient copayment of Y400 a day and an outpatient payment of Y800 a month.

**Standard monthly remuneration. A typical male worker under the government-managed scheme had a monthly standard remuneration in FY 1989 of Y269,653. The typical female worker in such a case earned Y156,120. A typical male worker under the society-managed plan had a standard monthly remuneration of Y331,837 in FY 1989. The typical female worker's SMR was Y185,616. The standard monthly remuneration does not include bonuses, which might be the equivalent of two to three months SMR.

***In principle this is to be shared equally by employer and insured. For government-managed health insurance the government subsidizes two-fifths of the amount of the insured person's contribution. Insurance societies can determine whether to impose the contribution within the 1% limit.

Source: Ministry of Health and Welfare, Insurance Bureau employees on the payroll. The government can require firms with more than 500 workers (including those in subsidiaries) to set up a health insurance society.

Through mandatory or voluntary participation an estimated 99 percent of the Japanese population is insured by either an employee-based insurance group, the national health insurance program or the Health Services Scheme for the Aged. As Table 1 shows, premiums vary widely. The most prestigious firms -- generally the largest -- might agree to cover the entire premium for workers enrolled in society-managed funds. Those employed by small or medium-sized firms may end up paying the entire premium on their own. And, just as in the United States, the self-employed who want insurance pay the entire amount themselves. A difference is that a critically ill Japanese worker is assured of being able to obtain insurance and does not have to worry about ineligibility because of preexisting conditions -- a problem found in the risk-averse coverage available from insurance companies in the United States. Selectivity for the insured exists indirectly in Japan, since employee insurance groups generally consist of those aged 55 or younger.

Disparities in what various participants contribute and the copayments that they make were the target of 1984 health-care reforms. Previously, copayment rates varied from nothing to 30 percent, depending on the insurance program. Now, workers not under the national health insurance plan face a uniform copayment of 10 percent (those enrolled in the NHI plan still pay 30 percent). Additionally, by creating a separate fund for the elderly the government tried to cut the high proportion of seniors enrolled in the national insurance plan. (The implications of this move will be addressed below.)

Another inequity posed by Japan's national health insurance scheme is that participants in some parts of the country may pay premiums 7.5 times greater than participants in the same scheme in a different municipality. (Locational differences in America also pose problems: 8.3 percent of the nonelderly population in Michigan is without health insurance, while 28.1 percent go without in New Mexico.[3]) The Ministry of Health and Welfare blames the high-end charges on a larger elderly population in the community, a greater number of hospital beds and more health awareness. In 1989 the ministry designated 147 localities as having extraordinarily high medical expenditures and urged them to rationalize their costs.

Effects of Rising Costs on Participants

Just as Washington has struggled to contain the rise in payments by the Medicare program for those aged 65 or older and the eligible disabled, Tokyo, too, is looking at ways to contain costs and utilization. Affordability of health care has different implications in the United States and Japan. Americans without insurance or with minimal coverage might be denied medical care, or avoid seeking it. One result is a system that treats the better-off and the very poor but ignores those that cannot afford care. The projected long-run impact of delayed care is a sicker patient eventually and higher medical bills that care providers will seek to recover either from government subsidies (giving state and federal governments cause for involvement) or by cost-shifting to insured patients. American employers, too, suffer as they try to configure

[3] Horkitz, op. cit., p. 6.

their benefits packages to avoid bearing the brunt of the escalating costs of medical care yet still attract quality employees and keep them healthy.

As regards affordability, Japan and other countries with variations of universal medical insurance coverage already accept one principle not yet confirmed by U.S. policymakers: that basic levels of health care are a citizen's right. Thus, while Washington neither guarantees access to health care for the public at large nor affordable health care for all citizens, Tokyo is required by the constitution (Article 25, Clause 2) to exercise responsibility for public health and social welfare.

Affordability for both payer and purchaser is a crucial element in a system of guaranteed access to health care. Whether to control costs by cost-sharing among participants, limitations on benefits or regulated fees and prices -- the usual trio of methods -- becomes a matter of public policy when the government is involved as a payer. Japan focused mostly on cost-sharing and regulation in the 1980s. Controlling costs is particularly important because Tokyo underwrites 50 percent of the national health insurance scheme and provides a more limited 16.4 percent subsidy for the government-managed insurance fund.

Government Role - In general the government pays about 31 percent of Japan's health care costs (see Table 2).[4] A steady climb in medical costs (see Table 3) is one reason the Ministry of Health and Welfare began introducing a

Table 2: Japan's Health-Care Receipts by Source of Funds, FY 1988-FY 1989

(in trillions of yen and billions of dollars*)

	FY 1988			FY 1989		
	Amount		Percent	Amount		Percent
	Yen	Dollars	of Total	Yen	Dollars	of Total
Government	Y5.85	$45.6	31.2%	Y6.20	$43.4	31.4%
Insurance System**	10.53	82.1	56.2	11.06	77.5	56.1
Patient Out of Pocket	2.32	18.1	12.4	2.42	17.0	12.3
Other	0.05	0.4	0.2	0.05	0.3	0.2
Total Receipts	18.76	146.2	100.0	19.73	138.1	100.0

*The FY 1988 figures were converted using Y128.26=$1.00; the FY 1989 exchange rate was Y142.83=$1.00.
**Includes company and employee contributions.

Source: Ministry of Health and Welfare

[4] A study by Katharine Levit and Cathy Cowan, "The burden of health care costs: Business, households and governments," Health Care Financing Review, XII, No. 2 (Winter 1990), pp. 127-137, indicates that the U.S. government also pays about 31 percent if judged solely by what the federal government contributes as subsidies and not what it pays as an employer. A traditional model shows the public sector contributing 42 percent if the above factors are not discounted (see Appendix).

Table 3: Indicators of Japan's Medical Expenditures, FY 1985-FY 1989

(in billions of yen)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
National Medical-Care Costs	Y16,015.9	Y17,069.0	Y18,075.9	Y18,755.4	Y19,729.0
Change	6.1%	6.6%	5.9%	3.8%	5.2%
National Medical-Care Costs as Share of GNP	4.9%	5.0%	5.1%	4.9%	4.9%
Change in GNP	6.4%	4.4%	4.9%	6.4%	7.2%
Medical-Care Outlays for Seniors	Y4,067.3	Y4,437.7	Y4,830.9	Y5,000.2	Y5,409.7
Change	12.7%	9.1%	8.9%	3.5%	8.2%
Cost of Senior Care as Share of National Medical Care	25.4%	26.0%	26.7%	26.7%	27.4%

Source: Management and Coordination Agency, Statistics Bureau, Japan Statistical Yearbook 1990, and Ministry of Health and Welfare.

variety of reforms in the 1980s. Another catalyst was the cabinet's 10 percent across-the-board cut in proposed discretionary spending for FY 1984 as Tokyo tried to tackle its budget deficit.[5] Among MHW's reforms were those requiring primary beneficiaries to be responsible for a 10 percent copayment (before coverage was 100 percent for some workers) and revising schedules for medical fees and drug prices.

Nevertheless, financial problems continue to plague government-affiliated health-care programs. Of the 3,429 local government units providing national health insurance coverage, 261 had a combined deficit of Y114.7 billion ($849.6 million) in FY 1988. The year before the general government-managed health insurance fund recorded a deficit, as did the mutual aid association funds that cover employees working for government-affiliated organizations (see Table 4). It is not readily apparent whether the rising costs have hit government or patients the hardest. The government's 31 percent contribution to health-care funding compares with a 12 percent patient out-of-pocket contribution (Table 2). The 12 percent figure, however, does not include any premium payments, which would be included under the insurance system category. Yet a worker might pay the entire premium or as much as half, depending on what share his or her employer pays to the insurance fund.

Patient's Involvement - Patients feel the weight of increases in medical costs either by adjustments in their premiums or the copayments they must make. As noted earlier, the cost of premiums varies greatly, depending on employment,

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[5] Mitsuru Fujii and Michael Reich, "Rising medical costs and the reform of Japan's health insurance system," Health Policy, IX, 1988, pp. 9-24.

Table 4: Financial Results of Various Japanese Insurance Programs, FY 1985-FY 1987

(in billions of yen)

Program	Fiscal Year	Net Revenues	Expenditures	Balance
Government-Managed	1985	Y3,889	Y3,623	Y266
	1986	3,981	3,940	41
	1987	4,181	4,318	-137
Society-Managed	1985	3,401	3,056	345
	1986	3,543	3,295	248
	1987	3,685	3,660	25
Mutual Aid Associations (for central government ministries and agencies)	1985	1,576	1,202	374
	1986	1,697	1,329	368
	1987	1,833	1,539	294
Mutual Aid Associations (for central government-affiliated organizations)	1985	1,266	1,143	123
	1986	1,233	1,224	9
	1987	1,352	1,387	-35
Mutual Aid Associations (for local governments)	1985	4,455	2,990	1,465
	1986	4,947	3,438	1,509
	1987	5,171	3,871	1,300
National Insurance	1985	5,001	5,165	-164
	1986	5,460	5,355	105
	1987	5,735	5,749	-14

Source: Management and Coordination Agency, Statistics Bureau, Japan Statistical Yearbook 1990.

age and sometimes location. People employed by major corporations typically pay only part of their premiums and possibly have access to in-house medical facilities as well (see JEI Report No. 40A, October 19, 1990). Health associations might provide more extensive cost-sharing for normal pregnancies, which are not covered under basic benefits. The value of delivery and childbirth coverage to participants in the government-managed employee-based system is clear from Table 5. Members of employee-based insurance funds also benefit in that when they retire and, typically, join the national health insurance program, they are eligible for 80 percent coverage instead of the 70 percent accorded most NHI enrollees. As health policy analysts Mitsuru Fujii and Michael Reich point out, however, this contributes to cross-generational inequities in the insurance program.[6]

Since health associations' membership is limited to only those who are employed (and fairly healthy by virtue of relative youth), not only are these funds' expected expenditures lower than that of the national health insurance

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[6] *Ibid.*, p. 16.

Table 5: Coverage by Type of Insurance Plan in Japan, 1988

	Government-Managed		Society-	National
	General	Day Laborers	Managed	Health Insurance*
Insured (thousands)	16,595	124	13,721	45,338
Medical Care				
Cases** (thousands)	118,881	1,386	85,649	271,218
Value (billions)	Y1,737	Y22	Y1,125	Y4,860
Sickness and Injury				
Cases (thousands)	1,249			
Value (billions)	Y139			
Delivery and Childbirth				
Cases*** (thousands)	234			310
Value (billions)	Y49			Y38
Other****				
Cases (thousands)	35		19,722	1,291
Value (billions)	Y9		Y113	Y27
Dependents (thousands)	17,884	n.a.	17,367	n.a.
Medical Care				
Cases (thousands)	115,029	308	116,111	
Value (billions)	Y1,092	Y5	Y953	
Spouse Delivery				
Cases (thousands)	311			
Value (billions)	Y62			
Spouse Child Care				
Cases (thousands)	306			
Value (billions)	Y0.6			

*Data for 1987.

**Includes benefits for retired employees under the Medical Care System for Retired Persons for national health insurance only.

***Delivery and childbirth expenses under national insurance are for midwifery benefits.

****Includes funeral expenses and unspecified benefits.

Source: Management and Coordination Agency, Statistics Bureau, Japan Statistical Yearbook 1990.

plan but copayments typically are lower, too. For example, in FY 1988 the average medical-care expenditure for an enrollee in a society-managed health fund was Y78,331 ($580); the copayment would have been Y7,833 ($58). The average cost for a dependent in a society-managed fund was Y65,733 ($487), of which Y13,147 ($97) would have been required as a copayment if all the costs were for inpatient services. The national insurance fund, which includes retirees of an age where health problems crop up frequently, averaged payments per enrollee of Y182,157 or $1,349, the highest of any of the funds; the copayment for a nonretiree would have been Y54,647 ($405) and Y36,431 ($270) for a retiree.

The inequities in the system are addressed only partially by a fund-redistribution plan the government imposed when it enacted the Health Services

Law for the Aged in 1983. This law commits a portion of the premiums paid to employee-based insurance funds to pay for retiree insurance. The insulation provided to the employee-linked associations from the expected demands of an expanding elderly population may not last, however. Among the ideas that have been proposed but not enacted are a hike in the copayment to 20 percent and exclusion of people with high incomes from insurance coverage.[7]

Various studies in the United States and elsewhere have indicated that higher copayments cut back the demand for medical care to a certain point.[8] Messrs. Fujii and Reich also noted that Japan's introduction of a 10 percent cost-sharing requirement for those covered by employee insurance "seems to have reduced the number of consultations sought. . . ."[9] Nevertheless, costs have continued to rise in Japan. Antidotes to the problem will be addressed later.

Employer's Posture - In the United States the role of benefits in wage and salary negotiations has mirrored the rise in medical costs. But Japanese employers in the latest spring wage talks heard more demands for vacations or shorter work weeks (see JEI Report No. 12B, March 29, 1991). Although companies that have employee-based health funds can adjust premiums to some degree, the variations have an upper limit set by the government and a practical limit set by competition with other employers in a tight labor market.

The average monthly cost of health insurance for firms surveyed for a Ministry of Labor study printed in 1988 found that one-third of the mandated benefits paid by employers was for health insurance or about 3 percent of the total monthly standard remuneration (which excludes bonuses). The average of surveyed firms across all industries was Y10,831 a month ($80), with the highest figure -- Y18,641 ($138) -- for utility company employees. These amounts do not include voluntary provision of health-care benefits, which amounted to a monthly average per employee of Y1,144 ($8.47). Although the measures are different, it is interesting to note that U.S. companies covered about 30 percent or $173.4 billion of total domestic expenditures in 1989 for health services and supplies, according to data from the Health Care Financing Administration. This figure, up 12.3 percent from 1988, included $128.8 billion for employees' private health insurance policies and another $28.5 billion as the employer's contribution under mandated rules for Medicare contributions.[10]

Perhaps hinting at the low level of involvement by the average employer in Japan's health-care system, an ad hoc committee for administrative reform proposed in 1981 that the government work to increase the participation of the private sector in coping with the strains on the social security system, the broad designation for Japan's social security and health insurance systems.[11] Keidanren (Japan Federation of Economic Organizations) has responded with papers addressing the need to cope with the increasing numbers of elderly in Japan, estimated to exceed one-fifth of the population by the year 2020.

[7] Ibid., p. 16.

[8] Congressional Budget Office, op. cit., p. 34.

[9] Fujii and Reich, op. cit., p. 19.

[10] Levit and Cowan, op. cit., p. 129.

[11] Fujii and Reich, op. cit., p. 15.

The impact on health-care expenditures of the growing elderly population could be significant, reaching 42.4 percent in the year 2000 (see Table 6). A 1990 report on Japan's economy by the Paris-based Organization for Economic Co-operation and Development furthermore warned that by the year 2020, the elderly could account for over half the nation's medical expenditures if the estimated 4.8-to-1 ratio of per capita spending for elderly to nonelderly remains constant. This compares with a 3.9:1 ratio in the United States in elderly to nonelderly health spending per capita. Yet the OECD figured that the United States would spend a slightly greater percentage on its elderly in 2020 than Japan would.[12]

Table 6: Average Annual Nominal and Real Growth in Various Countries' Health Expenditures, 1960-84

		Real Expenditures Due to Changes in:		Outlays and Projected* Outlays for Senior Care as Share of Total		
	Nominal Expenditures	Demographics	Per Capita Increases	1980	2000	2020
Japan	16.8%	1.1%	9.1%	31.3%	42.4%	52.5%
United States	11.8	1.1	4.1	47.0	48.8	56.9
Germany	10.1	0.4	3.8	32.7	34.1	40.0
France	15.3	0.8	7.0	28.4	30.0	35.8
United Kingdom	13.1	0.3	4.1	42.5	43.0	45.6
Italy	17.6	0.5	5.9	33.2	34.3	38.9
Canada	12.5	1.4	5.1	32.4	39.4	48.9

*Assumes constant per capita expenditure by age.

Source: Organization for Economic Cooperation and Development, Financing and Delivering Health Care (Paris: 1987).

Cost-Saving Efforts

Government's involvement as one of many payers for health care poses a risk that policy will favor economics at the expense of good medical practice. Messrs. Fujii and Reich have written that "health insurance policy seems to be leading medical services policy" in Japan.[13] The heavy component of private, fee-for-service care providers complicates the government's attempt to control costs. Further intruding on efforts to restrict rising costs is Japan's ever-higher standard of living, which began improving at the same time as medical procedures became increasingly complex and costly. The OECD calculated that Japan outpaced all other leading industrialized countries in its inflation-adjusted public health expenditures for the years 1960 through 1984 (Table 6). Karen Horkitz, writing on international health-care expenditures for the Employee Benefit Research Institute, noted that at least one report has pointed to a positive correlation between the rise in individual incomes and per capita consumption of health care services.[14] Not surprisingly, as Japan's per capita income climbed in the 1970s and 1980s medical services began using increasingly complex, and costly, equipment (see Table 7).

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[12] Organization for Economic Cooperation and Development, OECD Economic Surveys: Japan (Paris: 1990), p. 79.

[13] Fujii and Reich, op. cit., p. 20.

Table 7: Installation of Various Types of Complex Equipment in Japanese Hospitals, 1981 and 1987

	1981		1987	
Type of Equipment	Number of Hospitals	Pieces of Equipment	Number of Hospitals	Pieces of Equipment
Whole Body Computerized Tomography Scanners	647	664	3,018	3,224
Head-Only CT Scanners	904	910	937	944
Fibertracheobronchoscope	1,813	3,518	2,932	5,935
Fibergastroscope	5,429	13,668	6,508	15,824
Hemodialysis Apparatus	1,285	13,405	1,687	21,456
Electroencephalographs	--	--	5,992	7,468
Echographs	4,706	7,519	7,230	14,420

Source: Ministry of Health and Welfare, Statistics and Information Department, "Report on Survey of Medical Care Institutions."

Nevertheless, the government is mixing its efforts to adjust financing of health services with regulations on the supply side of medical care. Not all its plans have met success. The number of hospitals as well as the number of hospital beds have continued to expand despite attempted limits on the expansion of medical facilities (see Table 8). Observers of the health-care system suggest that efforts to regulate medical fees and pharmaceutical prices simply result in suppliers calling for more procedures or issuing more prescriptions to maintain their income levels. The same complaint echoes in the United States, where various spin-off effects have pushed up utilization to counter the government's moves to stem the rise in costs affecting Medicare programs.

Facility Regulation - The government's attempt to control the expansion of medical equipment and facilities, a counterpart to America's 1974 certificate-of-need legislation, is based on the 1948 Medical Services Law, which gave prefectural governments the duty of developing regional needs plans. Prefectures also are responsible for evaluating the construction and the staffing of new facilities. Yet the oversupply issue has not been clearly stressed. "The Japanese assumption appears to be that any excessive hospital construction will be controlled by competition," according to health policy analyst Milton Roemer.[15] A 1985 amendment to the Medical Services Law did focus on controlling expansion of the number of hospital beds. (Studies in both Canada and the United States have indicated that as the number of hospital beds climbs so does usage.) Analysts Fujii and Reich noted, however, that the amendment's success

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[14] Horkitz, op. cit., pp. 25-26.

[15] Milton Roemer, National Health Systems of the World, Vol. 1, The Countries (New York, N.Y.: Oxford University Press, 1991).

Table 8: Hospitals and Number of Beds by Ownership in Japan, 1980 and 1988

Type of Founder	1980 Hospitals	1980 Number of Beds	1988 Hospitals	1988 Number of Beds
Government	453	--	402	159,474
Other Public Groups*	1,369	--	1,368	342,403
Social Insurance Bodies	140	--	137	38,109
Medical Juridical Persons	2,896	--	3,855	599,819
Individuals	3,433	--	3,410	287,469
Other**	764	--	862	207,035
Total	9,055	1,319,406	10,034	1,634,309

*Includes hospitals established by local governments as well as the Red Cross and certain other public bodies.

**Includes company-owned hospitals, school-affiliated hospitals and public welfare juridical persons.

Source: Ministry of Health and Welfare, Health and Welfare Statistics in Japan 1990, and Management and Coordination Agency, Statistics Bureau, Japan Statistical Yearbook 1990.

has been questioned on two fronts. "While the amendment does control the addition of new beds, it does not provide authority to reduce the number of existing beds, when they may already be in excess. Moreover, rather than reducing the total number of beds, the regulation provides a rationale for adding new beds in areas where numbers are currently below the approved level."[16]

The Ministry of Health and Welfare in a report on an October 1989 survey credited local regulators for keeping the annual growth of hospitals to 0.5 percent. The addition of 47 hospitals brought the late 1989 total to 10,081; a 1.7 percent increase in hospital beds brought the number to about 1,669,520.[17]

Also factoring into attempted regulation of facility and equipment expansion is the power of the Japan Medical Association. Of the approximately 194,000 physicians in Japan, 121,514 belonged to JMA as of December 1990. Critics have said that JMA's influence also has thwarted implementation of any outside peer review, one of the methods attempted in the United States to challenge unnecessary medical procedures.

Regulation of Fees - Japan's fee-for-service medical system has operated under a government-set fee system since 1958. Revisions every two years attempt to keep the fees up-to-date, although JMA continually pushes for greater increases. In its most recent decision to review the 7,000 or so regulated fees MHW said that the system needs to be simplified. Among changes that a review panel will be considering are: adjustments in prices to reflect urban/rural differences, the availability of medical facilities and their level of proficiency and a more U.S.-style reimbursement that evaluates an entire procedure (a diagnostic-related group) rather than the piecemeal approach now used in Japan.[18]

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[16] Fujii and Reich, op. cit., p. 19.

[17] "Increase in Number of Hospitals Slows Down," The Japan Medical Review, V, No. 12, December 1990, pp. 3-4.

In a repeat of what most likely is heard in any country that attempts to regulate medical services, a major criticism of Japan's fee system is that doctors will find other ways to maintain or boost their income. International health analyst Roemer wrote, "The belief is widespread in Japan that physicians are abusing the health insurance program to enhance their earnings. The rate of appendectomies, for example, is extremely high -- three times the rate performed in England; more than 60 percent of appendices removed were found not to be inflamed."[19] Without significant peer review by an objective, preferably outside, organization such practices are likely to continue. Although the government attempts to check for billing fraud, its role is restricted in challenging physicians' professional opinions.

An associated complaint is that Japanese physicians supplement their income by selling the medication that they themselves prescribe. The practice has a dual return, Mr. Roemer noted. "Accordingly, it is often claimed that physicians customarily dispense only a small supply of drugs, so that the patient must return soon to be reexamined to receive an additional supply, as well as to yield a further fee."[20] Other critics have contended that a doctor's double role as prescriber and dispenser of drugs contributes to overprescription, a topic of considerable debate.[21] Mr. Reich pointed out that since pharmaceuticals carry more points for reimbursement than medical services, physicians have an added incentive to prescribe more drugs.[22] The Health and Welfare Ministry, however, has threatened to revise this practice by separating the prescribing and the dispensing powers.

Pharmaceutical Pricing - The tie-in between physicians prescribing and selling drugs has frustrated pharmaceutical companies, which are squeezed by the government's pricing controls and a desire to encourage physicians to prescribe their products over those of a competitor. When the government began drastically cutting the amount that it would reimburse for medications in the 1980s, drug firms generally cut their profit margins to continue offering discounts to physicians through wholesalers. Another result of the restricted reimbursement policy, however, was to increase drug companies' attention to new drugs, which could be priced higher since they had no precedents. Health analyst Reich noted that physicians, too, ended up prescribing the drugs that had higher profit margins and, thus, better discounts.[23] One effect of the cuts in drug reimbursement rates has been to shift the attention of Japanese pharmaceutical houses to overseas markets, Mr. Reich added.

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[18] "Drastic Review of Current Medical Fee System Under Way," *The Japan Medical Review*, VI, No. 2, February 1991, p. 3.

[19] Roemer, *op. cit.*, p. 160.

[20] *Ibid.*

[21] Michael Reich, "Why the Japanese Don't Export More Pharmaceuticals: Health Policy as Industrial Policy," *California Management Review*, XXXII, Winter 1990, p. 147.

[22] *Ibid.*

An area in which pharmaceutical companies benefit under current U.S. law is the manufacture of orphan drugs. Under the orphan drug law a manufacturer is encouraged to develop a drug even if demand is slight because it is used to treat rare diseases. In turn, the government allows a monopoly on sales for a certain time. Japanese pharmaceutical firms have asked MHW to provide favorable taxation, simplified evaluation and approval procedures and exclusive sales rights for orphan drugs under a process similar to U.S. law.

As scientific advances lead to more sophisticated medications and medical procedures, cost controls will become more difficult to implement. For this reason alone cultural attitudes toward health and welfare carry important implications for a country's ability to control costs.

Basics Shape Costs

Good health is key to keeping medical costs low, which is one reason preventive medicine is touted. Typically associated with good health is an adequate income level. A low rate of alcohol or drug abuse or similar societal problems that impact a nation's health bill also is a factor. Still another important component is age, since the elderly use more medical services than the young.

Projections that its rapidly aging population would make up at least one-fifth of the entire population in just 30 years spurred Japan in the 1980s to institute programs offering health checkups to people 40 and older in a bid to encourage health maintenance. In late 1989 the government unveiled its 10-year strategy to promote health care and welfare for the elderly, focusing on research into aging and ways to improve the nation's ability to care for the elderly at home. The 39-day average general hospital stay in Japan -- a figure far surpassing that of any other industrialized nation -- stems primarily from the use of hospitals to care for bedridden elderly. The shortage of both long- and short-term skilled nursing facilities is another problem that officials hope to offset partially by implementing a home-care network. A recently organized study group on home care is considering, among other subjects, whether a family should be reimbursed for the cost of nursing.[24]

Income supplements are designed to address a variety of social problems in Japan, but the general trend has been for fewer people to receive public assistance payments. The 1988 rolls showed nearly 1.2 million recipients, down from a high of over 2 million in 1951. Overall expenditures hit a peak in 1985 of Y1.5 trillion ($11.1 billion) but by 1987 had fallen to Y1.4 trillion ($10.6 billion). Assistance for medical expenditures comprised the biggest component, totaling Y68.2 billion ($505.5 million) in 1987, although this figure was off from the Y70.5 billion ($522.5 million) spent in 1985. Payments vary according to region, but for a three-member household that included a disabled father the payment in 1987 was Y136,444 ($1,011). Other forms of assistance include employment assistance and consideration for public housing. Among those eligible are fatherless families, motherless families and widows.

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[23] Ibid.

[24] "Group Organized To Study Costs Of Home Care," The Japan Medical Review, VI, No. 1, January 1991, p. 3.

The Health and Welfare Ministry points to public assistance programs as one of the successful ways in which income is redistributed in Japan. Even more important have been improvements in the social security and the pension systems (see JEI Report No. 21A, May 25, 1990). The measure used to judge improvements in income redistribution, the Gini coefficient, shows that the combination of social security benefits, medical-care costs and initial income, minus social insurance premiums, was responsible for a 12 percent improvement in income equality in 1987, the highest ever in MHW's records. Since the high proportion of nonworkers enrolled in the national health insurance program (29.6 percent) is a worry, the income redistributive effects of social policy are important to MHW's efforts to stabilize the health insurance system's base. (For a broader look at economic equality issues, see JEI Report No. 4A, February 1, 1991.)

Societal problems have yet to play a seriously disruptive role in driving up the costs of Japanese health care, although concerns about alcoholism and overwork may be prompting more use of counseling centers. In 1987 people in alcohol dependence rehabilitation used only 5.2 percent of the mental hospitals' inpatient services and 2.7 percent of their outpatient services. The percentage used by those complaining of overwork, a relatively new complaint, was not listed. Offenses involving narcotics climbed to a high of 1,909 arrests in 1988, while those associated with illegal use of stimulants involved 20,716 people, down from a high of 24,372 in 1984. Should job-related stress or narcotics begin taking more of a toll in Japan, the health system would suffer.

Other factors that could affect the country's health-care system include improvements in its somewhat undeveloped emergency services system, which sometimes results in lives being saved on the margin; that brings about more long-term rehabilitation costs. The Japanese still are coming to grips with recognizing cessation of brain waves as the cause of death; therefore, doctors do only a limited number of transplants, primarily those involving kidneys, corneas or partial liver transplants. An interim report issued in mid-June by an advisory panel to Prime Minister Toshiki Kaifu said that brain death is sufficient for a medical declaration of death instead of the current Japanese definition of no heartbeat. The distinction is that organ transplants, particularly of the heart, are impractical once the heart has stopped beating. A brain-dead patient's heart, however, can be kept beating for a time to allow a transplant. One professor of thoracic surgery at Tohoku University summed up the feelings of many in Japan: "The panel's opinion is not equivalent to a social consensus on the matter." The professor added, "Carrying out an organ transplant without a social consensus will undoubtedly cause confusion."[25]

Intransferability Issues

Differences in social attitudes about medical care may be less of a factor than others in determining whether the Japanese system could be used as a model for Americans interested in changing their health-care system. The trust that the Japanese have tended to place in their doctors -- "the doctor is god" attitude -- certainly bodes ill for a country interested in controlling that doctor's income. Americans are more skeptical of a doctor's abilities, as the level of malpractice suits indicates. Yet Americans have not pursued to any great degree cost-based comparison shopping for medical services. This approach, naturally, is not possible in one-doctor towns across rural America. But few urban dwellers check fees and select their health-care provider accordingly. Corporations, which pay a growing portion of the American health-care bill, have headed for this route in trying to enroll employees in managed-care networks, such as health maintenance organizations. The competition model only works so far, however, since technological advances in equipment, pharmaceuticals and medical procedures will boost the prices of health care.

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[25] "Brain Death Report Divides Experts," The Japan Times, June 15, 1991, p. 2.

The Japanese health insurance system assures broad access as well as lower costs through single-payer overhead and government-negotiated fees for services and supplies. Moreover, patient confusion is minimized because the insurance system is highly regulated. Yet the costs to both consumers and the government are high. Although the trend is downward, Americans already pay far more out of pocket for health care than the average Japanese. Per capita expenditures in 1988 were $1,298 in this country and Y133,600 ($1,043 at 1988's average exchange rate of Y128.15=$1.00) in Japan -- with the Japanese paying from a lower base, perhaps due to regulated fees for all medical services and pharmaceuticals. The true cost for the individual Japanese, including copayments, is difficult to determine from available data, however, since Japanese employers have some discretion in premium payments.

Another roadblock to the transferability of the Japanese system to the United States is the importance of the network of multiple insurance vendors to the American health-care system. The insurance industry would not take kindly to a wholesale adoption of the Japanese system. Other countries, including Japan, have assigned an adjunct role to the insurance industry to supplement basic services.

The positive aspects of the Japanese system -- nearly universal access, choice of physician and hospital, shared premium costs, cross-group subsidies that help relieve any one group's burden, and fee systems that can respond to innovations in health care -- have to be weighed against some of the negatives. These include the burden on the government to subsidize cost overruns and to regulate fees in such a way that providers can continue to propose what is best for a patient without first consulting a calculator. Perhaps in reviewing the Japanese system's pluses and minuses, U.S. health-care policymakers will gain more insight into costs and opportunities as well as the benefits of building a system on solid bases.

For further information, contact Pat Murdo.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Table 1: International Comparison of Publicly Funded Medical-Care Systems, April 1989

	Japan	United States	United Kingdom	West Germany	France	Sweden
Type of System	Social Insurance	Social Insurance*	Health Service (medical care) Social Insurance (cash benefits)	Social Insurance	Social Insurance	Health Service (hospitalization) Social Insurance (outpatient, cash)
Application	All citizens via employee health insurance funds and national health insurance operations	Pension recipients aged 65 and over and people on disability pensions	Medical-care benefits for citizens; cash benefits	Broadly divided into general and farmer plans but differs by occupation; not compulsory for high-income people; covers 93% of population	Broadly divided into general, special, agricultural and self-employed but differs by occupation	Medical care benefits for all residents plus cash benefits for workers with annual earnings below set amount and most housewives
Scheme	Government-managed health insurance and national health insurance	Medicare, including hospitalization insurance (Part A) and supplementary medical insurance (Part B)	National Health Service (medical care) National Health Insurance (cash benefits)	General Sickness Insurance System	General System	National Health Service (hospitalization) National Insurance (outpatient)
Financial Resources						
Insured	Government-managed plans: 4.15% of standard monthly pay plus 0.3% of bonus; NHI: average 1988 amount per household of Y138,600	Part A: 1.45% of pay up to annual ceiling of $48,000; Part B: $31.90/month	Medical care: insured and employer share 15% of cost; cash benefits: 5%, 7% or 9% of weekly pay up to ceiling	6.7% of pay on average	5.9% of pay	None except self-employed pay 10.1% of annual earnings for outpatient treatment
Employers	Government-managed plans: 4.15% of standard monthly pay plus 0.5% of bonus; NHI: none	Part A: 1.45% of pay up to annual ceiling of $48,000; Part B: none	Medical care: employer and insured share 15% of cost; cash benefits: 5%, 7%, 9% or 10.45% of weekly pay up to ceiling	6.7% of pay on average	12.6% of pay	Hospitalization: none; outpatient: 10.1 percent of wages
State Subsidy	Government-managed plans: 16.4%; NHI: 50%	Part A: none in principle; Part B: 74% (1987)	Medical care: about 85%; cash benefits: none	None in principle	None in principle but applies part of auto insurance premiums and other user taxes	Hospitalization: all; outpatient: about 15%

*Not listed is the federal-state program for the poor, Medicaid. Costs are split about 57-43 between the federal government and each state. Eligibility varies from state to state but hinges on poverty-level status.

Source: Ministry of Health and Welfare

Table 2: U.S. Health Services and Supplies, Expenditures by Payer, 1985-89

(in billions of dollars)

	1985	1986	1987	1988	1989
Total	$404.7	$436.3	$475.2	$524.1	$583.5
Private	280.2	304.4	329.5	365.1	405.1
Businesses	117.1	128.0	137.8	154.4	173.4
Employer Share of Private Health Insurance Premiums	87.5	93.0	99.7	113.2	128.6
Employer Input for Medicare Hospital Insurance Trust Fund	20.3	23.3	24.7	26.4	28.5
Other Employer Expenses*	9.2	11.7	13.3	14.8	16.2
Households	151.2	164.0	178.3	196.1	215.6
Employee Share of Private Health Insurance Premiums Plus Individual Policy Premiums	30.3	33.7	37.9	40.6	45.6
Employee and Self-Employed** Payments Plus Voluntary Premiums Paid to Medicare Hospital Insurance Fund	24.0	27.6	29.5	31.4	33.9
Premiums Paid to Medicare Supplementary Medical Insurance Fund	5.2	5.2	6.1	8.7	11.3
Out-of-Pocket Health Spending	91.7	97.4	104.7	115.5	124.8
Nonpatient Revenues	11.9	12.4	13.5	14.6	16.1
Public	124.5	131.9	145.7	159.0	178.4
Federal Government	69.0	70.0	76.7	84.2	95.5
As Employer, Contributions to Private Health Insurance	4.3	4.0	4.8	6.4	8.0
Adjusted Medicare Outlays	20.3	18.0	19.5	20.8	24.8
Medicare	72.1	76.9	82.9	90.5	102.1
Less Premiums and Contributions Paid as Employer to Medicare	51.8	58.9	63.4	69.8	77.3
Other Health Program Outlays***	44.4	48.1	52.4	57.0	62.7
State and Local Governments	55.5	61.9	69.0	74.9	82.9
As Employer, Contributions to Private Health Insurance	11.9	12.8	13.9	15.8	17.4
Employer Contributions to Medicare Hospital Insurance Fund	2.2	2.7	3.1	3.3	3.6
Medicaid	18.6	19.8	22.9	23.9	26.9
Hospital Subsidies	7.8	10.0	11.2	12.4	13.9
Other****	15.0	16.6	18.0	19.5	21.1

Addendum: Percentage Breakdown of Total Expenditures

	1985	1986	1987	1988	1989
Businesses	28.9%	29.3%	29.0%	29.5%	29.7%
Households	37.4	37.6	37.5	37.4	36.9
(Out-of-Pocket)	(22.7)	(22.3)	(22.0)	(22.0)	(21.4)
Nonpatient Revenues	2.9	2.8	2.8	2.8	2.8
Federal Government	17.0	16.0	16.1	16.1	16.4
State and Local Governments	13.7	14.2	14.5	14.3	14.2

*Includes worker compensation, temporary disability insurance and in-plant health services.

**Includes one-half of self-employment contribution to Medicare Hospital Insurance Trust Fund.

***Includes Medicaid, health programs through the Departments of Defense and Veterans Affairs, Indian Health Service, Maternal and Child Health funding plus other public health, medical and general hospital programs.

****Includes other public and general assistance, including Maternal and Child Health.

Source: Health Care Financing Review, XII, No. 2 (Winter 1990), p. 130.

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JEI

REPORT

A Two-Part Report: A and B

NO. 26A

July 12, 1991

JAPAN AND THE GLOBAL REFUGEE PROBLEM

Summary

The recent plight of Kurdish refugees fleeing Iraq after the Persian Gulf War refocused international attention on the plight of people displaced by persecution. The Kurds' despair caught the attention of the Japanese, who have responded more quickly than in the days following the fall of Saigon in 1975 when Tokyo drew criticism for its lack of attention to the surge of refugees from Vietnam. Now Japan is a country of initial asylum for refugees as well as a resettlement site. Its most significant contribution to the Kurdish situation as well as that of other refugees has been substantial financial support to international refugee organizations.

Yet many aid experts contend that Japan is not doing enough to resolve the refugee problem. The recent appointment of a Japanese human rights expert to serve as United Nations High Commissioner for Refugees is expected to direct more attention in Japan to the refugee problem as well as draw additional financial commitments from Tokyo for refugee relief. An often-heard refrain from refugee experts is that Japan needs to contribute more than money toward easing the overwhelming needs of refugees. Observers suggest that Japan could improve its performance in this area by allowing more refugees to resettle in the country and by making available greater personnel resources.

Background

Conflict and repression have driven people from their home countries in record numbers in recent years. The United Nations considers people with a

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"well-founded fear of persecution on account of race, religion, nationality, membership in a particular social group, or political opinion" to be refugees. By the end of 1989 their worldwide number had grown to more than 15 million, up from 8 million in 1980. Although some recent political developments have promised to address certain causes of refugee movement, including the democratization of parts of Eastern Europe and Latin America, continuing unrest elsewhere has forced massive numbers of people to leave such disparate countries as Afghanistan, Vietnam, Sudan and Iraq. Relief experts say that by mid-1991 the refugee population around the world was nearing 17 million.

Refugee resettlement and relief efforts expanded worldwide in the days following the Vietnam War as governments shared responsibility for those fleeing repression. Japan, which did not allow permanent refugee resettlement prior to 1979, took a very different path than countries with a long tradition of integrating refugees, such as the United States, Australia and Canada. While problems of population density and limited space constrained Japan's ability to accept refugees, cultural and political tenets also constituted barriers to refugee resettlement.

International pressure on Japan to assume greater responsibility for refugees has clashed with a homogeneous society traditionally considered closed to foreigners and reluctant to rely on or assist strangers. Moreover, in part because Japanese foreign policymakers adhered closely to the principle of nonintervention in other countries' domestic affairs, the government avoided human rights issues until the early 1980s, noted Sadako Ogata, the Japanese human rights expert appointed United Nations High Commissioner for Refugees in December 1990.[1]

Refugees began to arrive in Japan in small numbers following the end of the Vietnam War in 1975, yet the government was slow to allow them to settle permanently, citing Japan's close-knit culture and space problems. The intensified rush of refugees from Vietnam and Cambodia in 1979 and the accompanying international appeals for assistance soon led Tokyo to formulate a new approach to the refugee problem. By the spring of 1979 the government had announced an eight-point program, which included: a target of accepting 500 Indochinese refugees for resettlement in the country; promises to provide language and vocational training facilities for refugees in Japan; and tentative pledges to make additional commitments to refugee relief. Disputes among various government agencies and divided public opinion stretched the diplomatic efforts of then Prime Minister Masayoshi Ohira and Foreign Minister Sunao Sonoda in working out this package.

Later that year the escalating number of Indochinese fleeing in sometimes rickety boats to neighboring countries set the backdrop for Tokyo's decision to boost financial contributions to international refugee programs and expand the conditions under which Japan would serve as a country of first asylum.

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[1] Sadako Ogata, "Japan's United Nations Policy in the 1980s," Asian Survey, September 1987, p. 968.

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By doubling its contribution to UNHCR's General Assistance Program for Indochinese Refugees, Japan fulfilled a pledge to cover approximately half of the total cost of the program. Tokyo also announced that it would allow boat people temporary refuge without requiring a guarantee of acceptance from the governments of rescuing ships. Critics, however, continued to characterize Japan's resettlement quota as meager compared to the efforts of other countries. Washington's policy in the spring of 1979 was to accept 7,000 Indochinese refugees a month for resettlement in the United States. In 1985 Tokyo raised its resettlement ceiling for Indochinese refugees to 10,000. The numbers granted asylum in Japan have yet to near that ceiling.

Japan's Framework for Refugee Relief

Japan has focused its refugee relief efforts on first asylum and resettlement measures and financial cooperation. To help bolster the government's response Tokyo has turned to nongovernmental organizations and, to a much larger extent, international groups, many of which are associated with the United Nations.

Policymaking - In 1977 the Japanese government began addressing issues raised by the Indochinese refugee situation through an interministerial body comprised of officials from agencies involved in refugee issues. Key policy decisions regarding refugees continue to involve the Ministries of Labor, Education, Justice, and Health and Welfare as well as the Ministry of Foreign Affairs, which has the lead. The Foreign Ministry's Human Rights and Refugee Division is responsible for overall refugee policy in the international context, while other agencies handle their specific areas of expertise. The Ministry of Justice, for example, deals with border functions, while the Ministry of Labor oversees employment training.

Nongovernmental Organizations - The Human Rights and Refugee Division also is responsible for coordinating with Japan's nongovernmental organizations on refugee issues. More than 40 NGOs in Japan currently work on refugee assistance. Many of these groups were established following the government's 1979 decision to allow refugee resettlement in Japan. One organization founded that year, the Foundation for the Welfare and Education of Asian People, received a government commission to help establish refugee resettlement centers. The Ministry of Foreign Affairs has applauded NGO contributions to refugee relief and has indicated willingness to support their work. American aid experts note, however, that Japan still lacks the extensive involvement U.S. private voluntary organizations have in refugee relief in this country and overseas. They also point out that hands-on involvement by Japanese personnel is not as visible in terms of the work being done by refugee agencies outside the country.

Contributions to International Organizations - Although Tokyo has extended special bilateral assistance to Thailand, Pakistan and other countries offering shelter to refugees from neighboring regions, most of Japan's refugee assistance goes through international organizations. Japan is a big contributor to UNHCR as well as to other major organizations that work on behalf of refugees -- the United Nations Relief and Works Agency for Palestine Refugees in the Near East, the United Nations Border Relief Operations, the International Committee of the Red Cross and the International Organization for Migration.

Japan's contributions to international refugee organizations took a dramatic turn following Tokyo's 1979 decision to allow the resettlement of refugees on Japanese soil. That year the government increased its contribution to UNHCR from the year-earlier level of $10 million to $65 million. Through 1989, the latest year for which complete data are available, Japan remained the second-largest single donor to UNHCR. Its 1989 contribution of nearly $73 million accounted for more than 14 percent of total contributions to that organization (see Table 1). In 1989 Japan also ranked as the second-largest single contributor to the U.N. Relief and Works Agency for Palestine Refugees in the Near East and was the top donor to the U.N. Border Relief Operations.

That same year Japan was the largest nonmember contributor to the International Organization for Migration, a Geneva-based international organization of 39 member governments. IOM works closely with UNHCR and NGOs; it also handles technical and legal aspects of the resettlement of refugees and migrants. Tokyo earmarked its 1990 contribution to IOM for activities that included language training in Thailand and Europe, placement of qualified Cambodian experts in Thailand and Cambodia, plus resettlement and repatriation assistance in Latin America. The Japanese government also has been involved in IOM work with Afghan refugees, including a program aimed at helping Afghans return to assist in that country's reconstruction. IOM also received funds last year from the Japan Shipbuilding Industry Foundation and the Sasakawa Peace Foundation for programs in Southeast Asia and Latin America. In addition, Japan provides direct food aid to refugees in places like Cambodia and Afghanistan and in Africa's poorest countries through such operations as the U.N. Food and Agriculture Organization's World Food Program.

The Department of State's 1990 World Refugee Report noted that Japan's outlays to some of the major international refugee organizations jumped by more than a third between 1988 and 1989. Yet some critics contend that Japan's contributions in this area do not measure up, given its growing economic strength. Many observers expect that the late 1990 appointment of Ms. Ogata as UNHCR eventually will stimulate an increase in Japanese contributions to that financially troubled agency. Ms. Ogata has stressed that, in addition to directing more funding toward refugee programs, Japan must raise its level of participation. "The criticisms," she has said, "should be money, plus what; what else can Japan do?"[2]

Already the attention that Ms. Ogata has focused on the refugee issue among the Japanese is thought to have contributed to the unprecedented flood of private donations to UNHCR, largely to assist the Kurdish refugees. This spring Japanese citizens contributed $1.3 million to UNHCR; labor unions and religious groups added $2.2 million, and businesses donated $11.5 million. Ms. Ogata's prompting also reportedly was behind a relief fund established in April for victims of the Persian Gulf War. Support for the fund came from various Japanese industry groups, including Keidanren (Japan Federation of Economic Organizations) and Nikkeiren (Japan Federation of Employers' Associations), but included contributions from other organizations and citizens as well.

Aid experts differ in their assessments of how much UNHCR Ogata will be able to move her country toward accepting greater responsibility for refugee relief. While some believe she will heighten Japanese awareness of refugee

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[2] Marcus Brauchli, "Ogata, New U.N. Head of Refugees, May Push Her Native Japan for More Aid," Wall Street Journal, February 11, 1991, p. A6B.

Table 1: Top Contributors to Major International Refugee Organizations, 1989

(in thousands of dollars)

Donor	Amount	Share of Total Contributions
United Nations High Commissioner for Refugees (General and Special Programs)		
United States	$125,762	24.9%
Japan	72,823	14.4
European Community*	41,906	8.3
West Germany	34,467	6.8
Sweden	32,137	6.3
Total	505,578	100.0
U.N. Relief and Works Agency for Palestine Refugees in the Near East (General and Special Programs)		
United States	$61,300	30.0%
European Community*	45,145	22.1
Japan	16,122	7.9
Sweden	14,026	6.9
Italy	10,969	5.4
Total	204,301	100.0
U.N. Border Relief Operations		
Japan	$27,589	51.5%
United States	12,243	22.9
European Community*	4,012	7.5
Canada	2,553	4.8
France	1,401	2.6
Total	53,542	100.0
International Committee of the Red Cross		
Switzerland	$45,072	21.9%
United States	36,291	17.7
European Community*	25,762	12.5
Sweden	18,009	8.8
Japan	15,014	7.3
Total	205,671	100.0

International Organization for Migration

Member Governments		
West Germany	$9,468	32.3%
United States	6,398	21.9
Switzerland	1,428	4.9
Italy	1,310	4.5
Belgium	951	3.3
Other Donors		
Japan	$2,750	9.4
European Community*	1,898	6.5
UNHCR	169	0.6
Total	29,261	100.0

*In addition to EC members' individual contributions, joint EC funds are available for disaster and refugee relief.

Source: Department of State, World Refugee Report, September 1990.

problems, others contend that it could be extremely difficult to sway Japanese attitudes on this issue. Addressing Japanese reluctance to accept more refugees for resettlement, Ms. Ogata has said that such changes will take a long time, admitting, "[Y]ou should always look at Japan in a medium-term perspective -- at least 5 or 10 years."[3]

Refugees in Japan

By the end of 1990 roughly 7,200 Indochinese refugees had been resettled permanently in Japan. (Nearly all refugees accepted for resettlement in Japan have been from Indochina.) Among them are boat people landing in Japan, refugees from first-asylum camps in neighboring countries and persons leaving Vietnam under the UNHCR-sponsored Orderly Departure Program. In 1990 Japan granted permanent residence or asylum to 738 refugees, nearly all from Vietnam. Due to a 10-year residency requirement for citizenship, only about 100 refugees have become Japanese citizens, although that number is expected to increase with time.

A Surge in 1989 - In the decade before 1989 the number of refugees arriving in Japan rarely exceeded more than a few hundred a year. In 1989, however, the number of boat people arriving in Japan reached a record 3,498, more than double the number who came in 1980, the last record year. Moreover, in 1989 more than 2,800 of these refugees landed directly in Japan, in contrast to previous years when arrivals all had been rescued at sea. By yearend 1989 more than 2,100 Vietnamese refugees and asylum-seekers remained in Japan, awaiting resettlement there or in third countries. By the end of last year, according to the Department of State, the number of unsettled Vietnamese had been whittled

[3] Steven Weisman, "U.N. Choice: A Signal of a Bigger Role for Japan," New York Times, December 27, 1990, p. A3.

down to 822. Japan permanently resettled 461 refugees in 1989; 330 were from Vietnam, with the rest from Laos and Cambodia (see Table 2).

Table 2: Refugees Resettled and Persons Granted Asylum in Major Resettlement Countries

		1988	1989
Australia		10,301	11,663
Austria		1,785	2,070
Canada		28,588	35,000
Denmark		2,196	NA
Finland		312	424
France		8,794	8,711
West Germany		7,621	5,991
Japan		500	461
Netherlands		2,301	2,755
New Zealand		931	802
Norway		1,350	7,450
Spain		3,938	3,677
Sweden		17,601	23,961
Switzerland		680	821
United Kingdom	(est.)	1,000	1,587
Total		87,898	105,373
United States (fiscal year)		83,420	106,250

Source: Department of State, World Refugee Report, September 1990.

The rush of refugees into Japan in 1989 largely reflected new refugee policies in neighboring countries. In 1988 Thailand had begun to turn away Vietnamese asylum-seekers. The next year Malaysia initiated a policy of denying first asylum to large numbers of boat people, and South Korea closed its doors to most Indochinese refugees. Furthermore, asylum-seekers may have been trying to make their move before implementation of a June 1989 recommendation by the International Conference on Indochinese Refugees that refugees be screened more diligently.

Comprehensive Plan of Action - The more than 50 nations participating in the 1989 International Conference on Indochinese Refugees adopted a multilateral framework to address the crisis presented by a flood of Vietnamese refugees with fewer and fewer places to go. The Comprehensive Plan of Action called for recipient nations to determine the status of arriving refugees as well as protect and resettle asylum-seekers. Moreover, the plan set out voluntary repatriation programs. Japan, a party to the CPA, last year announced a contribution of roughly $13 million to support activities under the plan.

The CPA's recommendation of repatriation for those persons denied refugee status also emphasized that every effort should be made to encourage a voluntary return to the country of origin. In late 1989, however, several parties to the plan began to press for involuntary repatriation for persons judged to be seeking better economic conditions rather than political asylum. While the United States has argued that sufficient time is necessary to prove the effectiveness of voluntary repatriation, the issue remains a topic of discussion among many first-asylum countries in Southeast Asia.

Naoki Tanaka, parliamentary vice minister of foreign affairs, told the 1989 conference on refugees that "voluntary repatriation must be the major key to a lasting solution to the refugee problem." He added, however, that if the exodus of refugees continued to overwhelm the small numbers willing to return to their home countries, "It will be necessary to seek alternatives to voluntary repatriation immediately." Foreign Ministry sources say that Tokyo currently sees a need for involuntary repatriation, although the Japanese government generally does not force those denied asylum to return to their country of origin. In September 1989 Japan established a process for screening refugees in conformity with the CPA. Tokyo has not implemented the system, however, on the basis that no international agreement exists on how to handle people refused asylum.

Resettlement Efforts in Japan - With fewer destinations open to them, more Vietnamese boat people and the brokers who organized their passage began to look to Japan. Although resettlement centers were established in Japan as early as 1979, the country was unprepared for the flood of people seeking asylum in the late 1980s. Refugees in 1989 swamped the four public refugee facilities: the International Refugee Assistance Center in the Shinagawa area of Tokyo, the Omura Refugee Reception Center in Nagasaki prefecture, the Himeji Resettlement Promotion Center in Hyogo prefecture and the Yamato Resettlement Promotion Center in Kanagawa prefecture. Boat people arriving in Japan are directed to the Omura center where they meet with UNHCR officials, undergo medical checkups and receive training before going to the Shinagawa center or facilities operated by private organizations. The Shinagawa center generally shelters refugees anticipating settlement in third countries. Refugees from neighboring first-asylum countries seeking resettlement in Japan are directed to the Himeji and Yamato centers where they receive language education and "social adaptation training" as well as assistance in finding jobs and homes.

Many of the refugees arriving in Japan in 1989 hoped to settle there permanently, in contrast to previous years when Japan was viewed by most refugees as a temporary stopover. The 1989 influx also included more than 1,600 immigrants from the People's Republic of China posing as Vietnamese refugees, roughly 300 of whom were returned to China late that year. The arrival of illegal immigrants from China continues to present a dilemma for Japan.

At the 1989 summit meeting of the world's seven leading democracies Japan joined the other participating governments in signing a declaration promising to provide refuge to Chinese dissidents. However, implementation in Japan is questioned by some. Tokyo reportedly has been cautious about recognizing dissidents, citing concern that some Chinese students in the country might claim to be dissidents and try to work in Japan under the auspices of the agreement. The government does not have a policy of automatically renewing the visas of these Chinese students.

Japan's Efforts to Assist Refugees Overseas

Japan's refugee resettlement efforts have focused almost exclusively on Indochina. Its contributions to UNHCR, like its foreign aid, traditionally have been directed to Southeast and South Asia. Recently, however, Tokyo has broadened the scope of its refugee cooperation. At a 1990 meeting of UNHCR's Executive Committee the head of the Japanese mission in Geneva noted that recent Japanese refugee assistance included $7.3 million for Afghan refugees in Pakistan and Iran, $1.3 million to aid Liberian refugees and $1 million to help repatriate Nicaraguan refugees. Japan also has directed aid to refugees in Africa, the Middle East and Latin America through such international organizations as IOM, UNBRO and FAO's World Food Program. The most visible example of Japan's extension of humanitarian aid outside Asia, however, is its recent assistance to refugees who have fled their homes due to the conflict in the Persian Gulf.

Aid to Refugees of the Persian Gulf War - In an April stop in Japan following a fact-finding mission to Iran, Iraq and Turkey, UNHCR Ogata said she intended "to plead for the Japanese government to give more aid" on behalf of the nearly 1 million Iraqi refugees in Iran and roughly 600,000 on the Turkish border. That month Tokyo announced more than $100 million in funding for international relief organizations assisting Iraqi refugees. It also said that over $2 million worth of food, medicine and other emergency materials had been delivered to refugees in Iran and Turkey. In addition, Japan sent three medical relief teams in April to help refugees in Iraqi border areas.

During the Persian Gulf War Japan pledged $22 million to the International Committee of the Red Cross and the U.N. Disaster Relief Coordinator's Office as well as $38 million for the startup costs of an UNDRO refugee relief and repatriation program for refugees in countries bordering Iraq. The March cease-fire led UNDRO to revise its relief plans for the region and issue new appeals for assistance to the international community. Japan's April pledge of $100 million included $17.5 million previously disbursed to UNDRO, making the additional contribution $82.5 million. In June IOM reported receiving $7.5 million from the Japanese government and roughly $1.9 million from other Japanese donors for its Gulf Emergency Program.

Tokyo also appears set to provide additional relief to refugees in Iraq. In late May Foreign Ministry spokesman Taizo Watanabe said that Japan would extend financial assistance worth $500 million to the Kurdish refugees. Details of this aid package have yet to be settled, however (see JEI Report No. 20B, May 24, 1991).

Outlook

UNHCR Ogata has emphasized her hope that Japan, in becoming an economic power, also could become a humanitarian power. She and other international observers suggest that Japan could follow several routes toward greater leadership in resolving the worldwide refugee problem. They also caution that some paths may be difficult for Tokyo to pursue. The new UNHCR has noted, for example, that Japan may be slow to accept a greater resettlement burden; others concur that it could be politically difficult to boost Japan's cooperation in this area. Most relief experts agree, however, that Japan needs to contribute more than financial assistance.

In the political arena Japan has emphasized the importance of stemming the flow of refugees and has made a concerted effort to help settle one significant source -- the 12-year-long war in Cambodia. Tokyo also has urged the government of Vietnam to take actions aimed at halting clandestine departures.

UNHCR Ogata has suggested that Tokyo also will target the roots of refugee crises through its new guidelines for foreign aid, announced by Prime Minister Toshiki Kaifu in April. The guidelines call on the government to consider a recipient nation's policies in such areas as human rights and promotion of democracy (see JEI Report No. 16B, April 26, 1991).

In the area of personnel contributions Ms. Ogata has proposed that Japan work on developing relief experts. Some observers suggest that Tokyo needs to develop a better system for coordinating Japanese citizens interested in such work. On a broader level Foreign Minister Taro Nakayama has characterized Japan's response to international humanitarian crises as insufficient and recommended that Japan seek an appropriate model overseas. UNHCR Ogata has suggested that Tokyo study the approach of Scandanavian governments to refugee relief.

While the level of Japanese awareness of refugee issues is said to be high, the escalating refugee population and growing signs of "compassion fatigue" in other nations are likely to challenge Japan to take additional steps at home and overseas to address the problem. The likely focus will not be just financial aid but political involvement and personnel commitments as well.

For further information, contact Margo Grimm.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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BOJ Cuts Discount Rate

Give the Bank of Japan credit for achieving the next to impossible: the surprise announcement of a widely anticipated action. For months analysts had speculated -- despite repeated BOJ denials -- that the central bank would lower its discount rate within days or weeks. (The rate signals BOJ's intentions on the direction of monetary policy and directly influences an array of other interest rates.) By June, however, influential business leaders, such as Industrial Bank of Japan, Ltd. president Yoh Kurosawa, were stating publicly that they doubted that BOJ would change the key rate soon. Speculators shifted the likely date to late summer at the earliest.

The lull in expectations newly projected by the media and business leaders appears in retrospect to have set the stage for BOJ to surprise speculators with its July 1 announcement that it was lowering the discount rate from 6 percent to 5.5 percent, effective immediately. The change, the first since August 30, 1990, was the first reduction in the rate since February 1987. Within days a broad range of other interest rates for borrowers and depositors began dropping.

The latest adjustment brought Japan's discount rate into equality with its U.S. counterpart, but it still was above the 5.25 percent charged prior to the firm, which reportedly received Y35 million ($259,300 at Y135=$1.00) for the repair work and sold Y700 million ($5.2 million) worth of new parts to Iran. JAE is said to have falsified documents to obtain import and reexport permits from the Ministry of International Trade and Industry. In response, Prime Minister Toshiki Kaifu said July 5 that he would "ensure strict treatment [of the company] after elucidating the details of the case in accordance with laws." Japanese defense analysts, however, say that a ban on government procurement from JAE is unlikely because the company's products are essential components of the Air Self-Defense Force's equipment. Although analysts predict that the government will issue a steep fine and a warning to the company, MITI officials have indicated that JAE could be prohibited from exporting for up to three years if the allegations against it prove true.

The JAE scandal is particularly embarrassing to Japan because of Tokyo's stated readiness to assume a larger part in international politics through advocacy of arms control. Following the Persian Gulf War Japan focused on ways to take the lead on controlling global arms proliferation. New guidelines for foreign aid announced in April, for example, called for the government to consider whether a recipient country is developing and manufacturing weapons of mass destruction (see JEI Report No. 16B, April 26, 1991). Mr. Kaifu is expected to highlight this potential leadership role for Japan at the mid-July London gathering of the leaders of the world's seven major industrial democracies. He reportedly will unveil a new system for full disclosure of worldwide arms sales aimed at cutting down the flow of arms to terrorist or belligerent states. (Since most of the other summit participants are major arms exporters, the prospects for the Japanese proposal appear somewhat shaky.) In a July 5 meeting with the press Mr. Kaifu reportedly divorced the proposal from the JAE incident, but it remains to be seen whether international observers will do the same.

Margo Grimm

Sales To Japan Up But Criticism Continues

The structure of U.S.-Japan trade is just as important as the size of the bilateral trade gap. That line of thinking or some variation of it has become a staple of congressional testimony by Bush administration trade policymakers as well as by critics of the White House's Japan negotiating strategy (see JEI Report No. 22A, June 14, 1991). What now passes for the conventional wisdom on bilateral trade, however, is just the latest version of an argument that has been around for at least as long as the United States has bought more from Japan than it has sold to that country.

American trade policymakers and business executives complained repeatedly during the 1970s and the first half of the 1980s that Japanese trade policies and practices skewed U.S. exports toward industrial and agricultural inputs at the expense of manufactured products in which American suppliers had a competitive advantage. When sales of manufactures took off in the last part of the decade, the criticism took on a new cast. Japan's imports of manufactures, whether from the United States or elsewhere, were said to be substantially less than would be expected for a country of its economic standing (see JEI Report No. 19A, May 11, 1990). Over the last year or so the criticism has undergone another transformation. Now it is argued that high technology products make up too small a share of this country's Japan-bound exports.

The composition of U.S. exports to Japan changed significantly between 1985 and 1990 (see Table 1) as sales of manufactured products generally grew at a much faster rate than shipments of bulk commodities. Critics acknowledge as much, but they point out that manufactures still made up a smaller proportion of exports to Japan last year (about 62 percent) than to the European Community (80 percent-plus) (see Table 2). What they forget is that a disparity is arithmetically inevitable because the European Community has domestic sources of supply for most of the big-ticket industrial and agricultural inputs that Japan imports from the United States.

Table 1: Composition of U.S. Exports to Japan, 1985-90

	1985	1986	1987	1988	1989	1990	Value Change 1985-90
Food and Feed	22.4%	18.9%	19.8%	21.2%	19.1%	17.5%	68.3%
Industrial Supplies	39.0	44.7	36.7	34.9	35.0	31.4	72.8
Capital Goods	26.6	24.9	27.4	28.4	27.3	29.7	140.5
Automotive Products	1.1	1.1	1.4	2.2	2.5	3.6	639.5
Consumer Goods	6.6	6.8	9.9	9.8	12.5	14.2	363.8
Total Exports (million dollars)	$22,608	$26,797	$28,284	$37,732	$44,479	$48,580	114.9

Table 2: Composition of U.S. Exports to the European Community, 1985-90

	1985	1986	1987	1988	1989	1990	Value Change 1985-90
Food and Feed	9.8%	10.2%	9.1%	7.8%	6.0%	5.3%	8.9%
Industrial Supplies	30.1	28.3	27.1	26.1	25.8	25.9	72.6
Capital Goods	45.7	46.1	47.1	48.8	49.1	47.9	109.9
Automotive Products	1.8	1.9	2.3	2.7	2.9	3.2	258.9
Consumer Goods	7.5	8.7	9.0	9.6	10.8	11.9	220.2
Total Exports (million dollars)	$48,945	$52,862	$60,702	$75,829	$86,421	$98,118	100.5

Source: Department of Commerce, Bureau of Economic Analysis

Complaints about the differential growth of exports of low technology goods and sales of technology-intensive products to Japan over the 1985-90 period are harder to dismiss. While such products as computer equipment, semiconductors, telecommunications equipment, scientific and medical equipment, and aircraft were among the export pacesetters (see Table 3), the bilateral trade deficit in most of these products expanded (see Table 4) even while the gap between overall exports and imports was narrowing.

* * * * * *

The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

Table 3: U.S. Exports to Japan by End-Use Category, 1986-90

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Total Exports to Japan	$26,797	$28,284	$37,732	$44,479	$48,580
Food, Feed and Beverages	5,078	5,614	8,005	8,481	8,505
Wheat	425	350	426	477	421
Corn	868	1,024	1,611	1,595	1,673
Sorghum, Barley and Oats	182	181	233	351	316
Other Animal Feeds	231	228	326	327	286
Soybeans	837	782	1,033	866	818
Other Oilseeds	44	39	58	56	65
Meat and Meat Products	765	910	1,379	1,634	1,578
Dairy Products and Eggs	47	45	56	36	45
Fish and Fish Products	867	1,070	1,562	1,622	1,802
Fruits and Fruit Products	372	449	535	580	543
Vegetables and Vegetable Products	155	190	267	277	290
Nuts and Nut Products	125	105	122	125	116
Bakery and Confectionery Products	31	46	86	87	79
Wine	13	25	41	57	81
Other Alcoholic Beverages	23	49	105	110	130
Industrial Supplies and Materials	11,982	10,386	13,157	15,546	15,232
Raw Cotton	251	423	482	547	579
Unmanufactured Tobacco	230	302	213	297	305
Hides and Skins (incl. furskins)	336	380	467	408	457
Metallurgical-Grade Coal	534	443	525	503	510
Other Coal	35	43	77	452	463
Fuel Oil	391	409	349	236	164
Other Petroleum Products	211	337	404	515	594
Natural Gas	187	149	154	158	162
Nuclear Fuel Materials and Fuels	600	526	476	790	562
Logs, Lumber, Plywood and Veneers	1,110	1,584	1,928	2,392	2,312
Manufactured Wood Supplies	15	29	46	81	109
Paper Base Stocks	576	760	1,057	993	778
Newsprint and Other Paper Products	346	389	459	513	489
Cotton and Other Natural Fibers, Yarn and Fabric	10	29	42	65	51
Synthetic Fibers, Yarn and Fabric	49	59	91	93	107
Synthetic Rubber	69	70	80	52	51
Plastic Materials	305	385	498	446	450
Fertilizers, Pesticides and Insecticides	256	298	295	267	274
Industrial Inorganic Chemicals	144	167	232	281	247
Industrial Organic Chemicals	580	689	908	998	987
Iron Ore, Steel Scrap and Ferroalloys	167	125	163	158	164
Steel Slabs, Bars, Wire Rods, Plates and Sheets	25	18	92	224	145
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	36	36	57	187	67
Aluminum	406	662	1,180	1,504	1,331
Copper	191	192	377	424	639
Nonmonetary Gold	3,340	14	99	78	19
Other Precious Metals	77	115	195	130	199
Other Nonferrous Metals	180	202	318	298	318
Fabricated Metal Products	97	126	165	176	155
Unmanufactured Nonmetallic Minerals	126	148	178	111	117
Manufactured Mineral Supplies	77	91	105	290	319
Blank Audio and Video Tapes and Other Media	74	94	142	131	141
Capital Goods	6,682	7,762	10,716	12,152	14,438
Electric Machinery	454	513	681	730	712
Generators, Transformers and Accessories	58	64	95	96	144
Other Electric Apparatus and Parts	396	449	587	634	567
Nonelectric Machinery	4,329	5,277	7,667	9,605	10,358
Excavating, Paving and Construction Machinery	34	40	69	127	143
Nonfarm Tractors and Parts	59	67	110	99	105
Industrial Engines, Pumps, Compressors and Generators	111	129	166	267	303
Food and Tobacco Processing Machinery	26	35	41	75	75
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	166	145	216	231	240
Textile and Sewing Machinery	22	25	41	69	56
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	46	46	70	58	76
Pulp, Paper, Printing and Packaging Machinery	77	81	124	122	134
Measuring, Testing and Control Instruments	481	580	842	656	739

	1986	1987	1988	1989	1990
Materials Handling Equipment	$25	$31	$59	$72	$93
Photo and Service Industry Machinery	125	159	198	291	298
Agricultural Machinery and Equipment	24	33	47	70	81
Computers	407	504	803	1,246	1,320
Computer Peripherals, Accessories and Parts	1,005	1,225	1,743	1,859	2,245
Semiconductors	360	550	841	1,171	1,297
Telecommunications Equipment	326	456	621	978	974
Other Office and Business Machines	101	124	102	192	148
Scientific, Hospital and Medical Equipment	446	578	775	716	1,113
Transportation Equipment	1,899	1,971	2,368	1,818	3,368
Civilian Aircraft	1,163	1,100	1,306	720	2,178
Parts for Civilian Aircraft	380	456	523	608	675
Engines for Civilian Aircraft	272	311	430	374	420
Marine Engines and Parts	61	93	92	71	65
Automotive Vehicles, Parts and Engines	302	406	826	1,123	1,760
Cars	56	111	348	481	869
Trucks, Buses and Special Vehicles	19	20	46	66	127
Automotive Tires and Tubes	21	62	147	178	180
Automotive Parts and Accessories (incl. engines)	206	213	285	397	584
Consumer Goods	1,821	2,788	3,701	5,571	6,897
Manufactured Consumer Nondurables	1,087	1,630	2,010	2,417	2,972
Textile Apparel, Footwear and Household Goods	39	76	136	183	270
Nontextile Apparel, Footwear and Household Goods	40	61	77	109	98
Sporting and Camping Apparel, Footwear and Gear	32	59	60	27	43
Pharmaceutical Preparations	639	701	849	870	805
Printed Material	62	77	105	137	146
Toiletries and Cosmetics	32	49	40	66	82
Cigarettes and Other Tobacco Manufactures	131	495	614	874	1,315
Manufactured Consumer Durables	624	996	1,460	2,927	3,618
Furniture	19	23	37	54	56
Cookware, Cutlery, House and Garden Wares and Tools	41	56	39	59	53
Household and Kitchen Appliances	25	29	35	94	93
Floor Coverings	9	21	37	61	52
Pleasure Boats and Motors	16	31	56	97	177
Toys, Sporting Goods, Bicycles and Motorcycles	101	185	286	465	473
Musical Instruments and Photographic and Optical Equipment	41	60	75	104	98
Television Sets and Other Video Equipment	14	14	30	64	57
Radios, Stereo Equipment and Other Audio Equipment	8	7	16	62	65
Records, Tapes and Disks	44	70	121	220	261
Jewelry and Watches	45	67	89	153	229
Artwork and Antiques	162	310	499	1,258	1,746
Unmanufactured Consumer Goods	111	163	231	227	308
Gemstones	107	158	226	220	300
Other Exports	931	1,329	1,326	1,606	1,748

Source: Department of Commerce, Bureau of Economic Analysis

Table 4: U.S. Imports from Japan by End-Use Category, 1986-90

(in millions of dollars, Customs value)

	1986	1987	1988	1989	1990
Total Imports from Japan	$80,722	$84,592	$89,762	$93,482	$89,684
Food, Feed and Beverages	509	465	406	348	327
Fish and Fish Products	313	265	200	176	151
Industrial Supplies and Materials	7,549	7,987	8,495	8,563	8,397
Paper and Paper Products	122	155	174	183	186
Cotton Fibers, Yarn and Fabric	165	155	124	119	115
Synthetic Fibers, Yarn and Fabric	514	462	406	358	323
Plastic Materials	424	514	509	564	593
Fertilizers, Pesticides and Insecticides	20	22	27	53	65
Industrial Inorganic Chemicals	107	147	144	173	184
Industrial Organic Chemicals	560	652	720	688	629
Steel Slabs, Bars, Wire Rods, Plates and Sheets	1,433	1,524	1,584	1,674	1,457

	1986	1987	1988	1989	1990
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	$710	$712	$841	$685	$571
Fabricated Steel Products	500	518	590	575	563
Fabricated Nonferrous Metal Products	564	513	444	415	559
Blank Audio and Video Tapes and Other Media	833	809	752	671	723
Capital Goods	23,441	27,697	32,834	36,872	34,567
Electric Machinery	2,337	2,853	3,468	3,122	3,277
Generators, Transformers and Accessories	569	634	807	411	451
Other Electric Apparatus and Parts	1,768	2,219	2,661	2,711	2,825
Nonelectric Machinery	20,736	24,324	28,810	32,973	30,549
Drilling and Oilfield Equipment	346	137	373	251	244
Specialized Mining and Oil Processing Equipment	382	525	563	478	517
Excavating, Paving and Construction Machinery	321	414	436	433	480
Nonfarm Tractors and Parts	20	83	105	269	272
Industrial Engines, Pumps, Compressors and Generators	638	905	1,140	1,163	1,212
Food and Tobacco Processing Machinery	85	118	94	106	81
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	1,532	1,505	1,742	2,056	1,674
Textile and Sewing Machinery	228	292	403	543	408
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	359	478	557	813	624
Pulp, Paper, Printing and Packaging Machinery	382	328	348	472	448
Measuring, Testing and Control Instruments	570	674	818	764	783
Materials Handling Equipment	597	587	524	650	459
Photo and Service Industry Machinery	872	923	988	1,307	1,123
Agricultural Machinery and Equipment	512	550	494	438	401
Computers	583	617	648	619	469
Computer Peripherals, Accessories and Parts	4,114	5,768	7,050	7,929	8,108
Semiconductors	1,438	1,965	3,278	3,876	3,299
Telecommunications Equipment	3,350	3,647	3,851	4,984	4,083
Other Office and Business Machines	2,385	2,446	2,511	2,539	2,368
Scientific, Hospital and Medical Equipment	818	867	984	1,163	1,446
Transportation Equipment	369	519	557	778	741
Parts for Civilian Aircraft	189	255	322	387	471
Engines for Civilian Aircraft	53	35	58	97	84
Railroad Equipment	63	134	89	72	46
Marine Engines and Parts	53	55	63	182	140
Automotive Vehicles, Parts and Engines	32,620	33,690	32,789	33,685	32,120
Cars	20,950	21,273	19,873	20,140	19,522
Trucks, Buses and Special Vehicles	5,462	4,726	3,477	2,855	1,964
Bodies and Chassis for Trucks and Buses	188	226	263	86	93
Automotive Engines and Engine Parts	1,014	1,405	2,011	3,087	2,429
Automotive Tires and Tubes	478	498	641	818	752
Other Automotive Parts and Accessories	4,528	5,562	6,525	6,700	7,360
Consumer Goods	15,794	13,940	14,252	12,954	12,919
Manufactured Consumer Nondurables	1,419	1,400	1,450	1,514	1,371
Cotton Apparel and Household Goods	227	182	112	71	53
Other Textile Apparel and Household Goods	219	174	163	123	77
Nontextile Apparel and Household Goods	47	47	43	84	96
Pharmaceutical Preparations	271	336	344	360	341
Printed Material	188	194	218	191	186
Manufactured Consumer Durables	14,195	12,400	12,642	11,370	11,459
Glassware and Chinaware	396	375	333	275	262
Cookware, Cutlery, House and Garden Wares and Tools	249	209	209	192	168
Household and Kitchen Appliances	901	737	625	418	645
Motorcycles and Parts	856	556	629	586	403
Pleasure Boats and Motors	248	322	447	213	162
Toys and Sporting Goods (incl. bicycles)	729	931	1,633	2,108	2,632
Photographic and Optical Equipment	1,021	1,079	952	772	695
Musical Instruments and Other Recreational Equipment	392	544	549	393	350
Television Sets and Other Video Equipment	5,581	3,608	2,810	3,230	3,005
Radios, Stereo Equipment and Other Audio Equipment	2,513	2,754	3,223	2,212	1,945
Jewelry and Watches	467	526	556	356	521
Artworks and Antiques	86	63	43	101	123
Unmanufactured Consumer Goods	179	139	161	70	90
Other Imports	809	814	985	1,061	1,355

Source: Department of Commerce, Bureau of Economic Analysis

NOTE

ONLY THE FOLLOWING PAGES OF THIS
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Entire Issue

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JAPAN · ECONOMIC · INSTITUTE
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REPORT

A Two-Part Report: A and B

NO. 27A July 19, 1991

JAPAN'S ECONOMIC RELATIONS WITH TAIWAN

Summary

Business relations between Japan and Taiwan have flourished in the 20 years since diplomatic ties were severed. Today Taiwan is Japan's fourth-largest trading partner, while Japan ranks second in Taiwan's two-way trade. But the growing importance of the two economies to each other also has created problems. Taiwan runs a significant deficit in its trade with Japan, even though it has a substantial surplus both overall and with the United States, its top trading partner.

Dealing with complicated issues like the bilateral trade imbalance is difficult in the absence of official relations between the two governments. Last year Taipei's mounting frustration with Tokyo's seeming reluctance to do anything about the widening gap in two-way trade led to a package of measures designed to force change. This move has put pressure on the business communities on both sides to find ways to reverse the growth of the bilateral trade imbalance.

Japanese companies have been the largest foreign direct investors in Taiwan since 1988. Plus, they are a primary source of technology for Taiwanese industry. The two business sectors also cooperate in investing in Southeast Asian markets. Although the political atmosphere sometimes complicates economic relations between Japan and Taiwan, the keen business interests of both partners could foster the creation of a strong regional market in East Asia.

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Maintaining Relations

The Nationalist government in Taipei severed diplomatic relations with Tokyo following Japan's September 1972 official recognition of the People's Republic of China; that move acknowledged Beijing's claim to be the sole legitimate government of both mainland China and the island of Taiwan.* Months earlier the Taiwanese government had experienced a shock when then President Nixon visited mainland China and set a course that led to the establishment of diplomatic relations between the United States and the PRC at the beginning of 1979. The communique issued after Mr. Nixon's February 1972 visit recognized Taiwan as a part of China but said the Chinese themselves should settle peacefully the questions of how to address the Taiwan issue.

With official ties broken, Tokyo and Taipei set up parallel semigovernmental organizations in December 1972 -- the Chinese/Japanese Interchange Association on the Japanese side and the Association of East Asian Relations on the Taiwanese side -- to serve as channels for informal relations and to take over some services no longer provided by the two governments, such as immigration. (Similarly, Washington's affairs are handled through the American Institute in Taiwan, while Taipei maintains ties through the Coordinating Council for North American Affairs.) In Japan's case, retired ambassadors have served as the head of the Taipei office of the Chinese/Japanese Interchange Association; Taipei has assigned high-ranking government officials or party leaders as the chief representative of the Tokyo office of the Association of East Asian Relations. The two organizations hold annual meetings to exchange information, discuss problems in trade or other parts of the Japan-Taiwan economic relationship and, if necessary, convey requests to and from their governments.

Although Tokyo and Taipei have channels of communication, it sometimes is difficult for them to resolve bilateral economic problems, such as those involving trade barriers, protection of intellectual property rights and investment regulations. Unlike trade talks undertaken by governments, the meetings between the pair of semigovernmental organizations do not provide authoritative grounds to settle economic disputes. Moreover, except for membership in the Asian Development Bank, Taiwan is not a participant in or has not been allowed to join the principal international organizations or forums, such as the United Nations, the International Monetary Fund, the World Bank and the General Agreement on Tariffs and Trade. This means that Tokyo and Taipei do not have the chance to communicate with each other in a multilateral setting.

The absence of government-to-government relations also impedes financial services between Japan and Taiwan. Since Tokyo cut off foreign aid to Taiwan and the Export-Import Bank of Japan stopped providing export credits and other

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*Beijing does not take Japan's one-China policy for granted. It actively monitors Tokyo's attention toward Taipei, most recently opposing any official or unofficial invitation to Taiwan's president to visit Japan. An invitation would indicate, a Chinese Embassy representative in Tokyo said, that Tokyo had decided to adopt a "two-Chinas" or a "one China, one Taiwan" policy.

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forms of financing, Japanese companies have had to tap the commercial banking system to finance trade with Taiwan or investment there. That dependence has not curtailed the expansion of business with Taiwan since transactions there fall into the low-risk category. But Japanese traders and investors potentially face some financial complications because only a single branch of a Japanese bank, set up before 1972, is in operation in Taiwan. Other banks interested in opening offices in Taiwan have run into opposition from the Japanese government, which is concerned about the impact of such a move on relations with Beijing.

Air services indicate some other drawbacks to the absence of diplomatic relations between Japan and Taiwan. While Beijing's national flag carrier serves the high-traffic Narita and Osaka airports, Taipei's China Airlines is limited to the Haneda and Fukuoka airports. For its part, Japan Airlines, which provides service to mainland China, set up a subsidiary, Japan Asia Airways, to fly from Narita and Osaka to Taiwan.

Taiwan's Economic Growth and Its Trade Structure

Despite the lack of official relations between Tokyo and Taipei and the complications this adds to the bilateral economic relationship, Japan's business ties to Taiwan have proliferated, especially in recent years. For example, from 1985 until they leveled off in 1990 both exports to Taiwan and imports from there expanded at a much faster rate than Japan's overall trade (see Table 1). By last year Taiwan was Japan's fourth-biggest market and its ninth-largest supplier (see Table 2).

Table 1: Japan's Trade with Taiwan, 1970-90

(in millions of dollars; exports f.o.b., imports c.i.f.)

Year	Exports	Imports	Balance
1970	$700	$250	$450
1975	1,821	811	1,010
1980	5,146	2,293	2,852
1981	5,405	2,523	2,882
1982	4,255	2,443	1,812
1983	5,086	2,622	2,463
1984	5,986	3,204	2,782
1985	5,026	3,386	1,640
1986	7,852	4,691	3,161
1987	11,346	7,128	4,218
1988	14,354	8,744	5,611
1989	15,421	8,979	6,442
1990	15,430	8,496	6,933

Source: Japan Tariff Association

The fast-paced increase in Japan's trade with Taiwan in the second half of the 1980s mainly paralleled the rapid expansion of the Taiwanese economy. Real economic growth surpassed 12 percent in both 1986 and 1987. Although the

Table 2: Japan's Major Trading Partners, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share	Imports	Amount	Share
United States	$90,322	31.5%	United States	$52,369	22.3%
West Germany	17,782	6.2	Indonesia	12,721	5.4
South Korea	17,457	6.1	Australia	12,369	5.3
Taiwan	15,430	5.4	China	12,054	5.1
Hong Kong	13,072	4.6	South Korea	11,707	5.0
United Kingdom	10,786	3.8	West Germany	11,487	4.9
Singapore	10,708	3.7	Saudi Arabia	10,462	4.5
Thailand	9,126	3.2	Arab Emirates	9,085	3.9
Australia	6,900	2.4	Taiwan	8,496	3.6
Canada	6,727	2.3	Canada	8,392	3.6
Total Exports	286,948	100.0	Total Imports	234,799	100.0

Source: Japan Tariff Association

rise in inflation-adjusted gross national product slowed to 7.8 percent in 1988 and then to 7.2 percent the next year before dropping to 5.3 percent in 1990, last year's growth still exceeded that of most industrialized countries. Reflecting this strong performance as well as the roughly 50 percent appreciation of Taiwan's currency against the dollar in the five years following the Plaza Accord, Taiwanese per capita income jumped to $7,990 in 1990 from $3,297 in 1985. Among Asian economies that figure put Taiwan fifth after Japan, Brunei, Singapore and Hong Kong, and it was more than 20 times as large as the PRC's per capita income. Officials in Taipei expect per capita income to reach $14,000 by 1996; such a figure would put Taiwan in the ranks of industrialized countries.

Exports have fueled Taiwan's rapid economic growth. The share of exports in gross national product hit 48 percent in 1989. That number not only was far above the comparable figures of 9.7 percent for Japan and 7 percent for the United States but made Taiwan's export dependency greater than Europe's. The economy's heavy dependence on exports stems partly from the relatively small size of the domestic market (20 million people). It also reflects Taiwan's international political status, which prevents Taipei from getting foreign official credits to pay for imports. The economy's success in exporting has resulted in a string of fairly sizable trade surpluses and foreign currency reserves amounting to more than $70 billion as of December 1990 -- a figure that puts Taiwan in Japan's league.

Taiwan's main export market is the United States. Although attempts to diversify overseas shipments by putting more emphasis on sales to Europe, Southeast Asia and China (through Hong Kong) dropped the U.S. share to 32 percent in 1990 from nearly 50 percent in 1984, this country still is Taiwan's most important market. Japan ranked third last year, right behind Hong Kong (see Table 3).

Taiwan mainly buys production equipment, parts and components and manufactured industrial supplies from Japan (see Table 4), its largest source of

Table 3: Taiwan's Major Trading Partners, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share	Imports	Amount	Share
United States	$21,746	32.4%	Japan	$16,071	29.4%
Hong Kong	8,557	12.7	United States	12,612	23.0
Japan	8,346	12.4	West Germany	2,668	4.9
West Germany	3,181	4.7	Australia	1,660	3.0
Singapore	2,204	3.3	Saudi Arabia	1,539	2.8
United Kingdom	1,979	2.9	Hong Kong	1,446	2.6
Netherlands	1,856	2.8	Singapore	1,406	2.6
Canada	1,559	2.3	South Korea	1,344	2.5
Thailand	1,424	2.1	Switzerland	1,201	2.2
Australia	1,279	1.9	United Kingdom	1,154	2.1
Total Exports	67,214	100.0	Total Imports	54,719	100.0

Source: Taiwanese Government

imports, and the United States, its number-two supplier. These imports are used to manufacture the consumer goods and the low-technology capital goods that make up a substantial share of Taiwan's exports. Since the network of domestic parts producers is not well-developed, Taiwanese manufacturers rely on foreign, especially Japanese, suppliers for these inputs. While only 30 percent or so of Taiwan's total imports come from Japan, its manufacturing sector is heavily dependent on Japanese suppliers for certain types of parts, machinery and industrial materials.

Trade Imbalance with Japan

Although Taiwan runs a significant surplus in its overall trade, it buys far more from Japan than it sells to that country (see Table 5). Moreover, the gap has widened almost in lockstep with the expansion of Taiwan's worldwide exports. In 1990 the bilateral imbalance reached an all-time high of $7.7 billion based on Taiwanese statistics and $6.9 billion according to Japanese data. Until the late 1980s trade policymakers in Taipei generally did not consider the rising deficit with Japan to be a major problem, but the red ink in the Taiwan-Japan trade account has become a growing source of bilateral friction in recent years, in part because of developments in Taiwan's trade with the United States.

Taiwan's generally expanding deficit with Japan in the 1980s was accompanied by a growing surplus with the United States. By 1987 U.S.-bound exports topped purchases of American-made products by $16 billion. The corresponding deficit in the U.S. trade account made Taiwan second only to Japan as a contributor to 1987's record overall trade deficit. That ranking gave fresh momentum to Washington's long-running campaign to get Taiwan to boost imports from the United States. Taipei responded by dispatching import-promotion missions here and dismantling additional trade barriers. New export markets also were sought to trim Taiwanese dependence on U.S. sales. Together, these measures helped cut Taiwan's surplus with the United States to $9.1 billion in 1990.

Table 4: Commodity Composition of Japan's Trade-with Taiwan, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share
Food	$288	1.9%
Textiles and Apparel	516	3.3
Chemicals	1,848	12.0
Plastic Materials	464	3.0
Nonmetallic Mineral Products	306	2.0
Metals and Fabricated Metal Products	1,836	11.9
Steel	1,170	7.6
Nonferrous Metals	381	2.5
Metal Products	286	1.9
Machinery and Equipment	9,057	58.7
Nonelectric Power Generating Machinery	333	2.2
Computers and Other Office Machines	615	4.0
Metalworking Machinery	255	1.6
Textile Machinery	213	1.4
Electric Power Generating Machinery	269	1.7
Television Sets	154	1.0
Electronic Tubes and Semiconductors	1,580	10.2
Motor Vehicles	312	2.0
Scientific and Medical Equipment	335	2.2
Other	1,580	10.2
Total Exports	15,430	100.0

Imports	Amount	Share
Food	$2,165	25.5%
Meat	709	8.3
Fish	972	11.4
Textile Fibers	53	0.6
Metal Ores and Scrap	95	1.1
Other Raw Materials	271	3.2
Logs and Lumber	97	1.1
Mineral Fuels	11	0.1
Chemicals	334	3.9
Machinery and Equipment	2,038	24.0
Computers and Other Office Machines	204	2.4
Scientific and Medical Equipment	227	2.6
Other	3,529	41.5
Steel	315	3.7
Nonferrous Metals	173	2.0
Textiles and Apparel	737	8.7
Toys and Games	97	1.1
Total Imports	8,496	100.0

Source: Japan Tariff Association

Table 5: Taiwan's Trade Balance with Major Trading Partners, 1985-90

(in billions of dollars)

	1985	1986	1987	1988	1989	1990
Japan	$-2.1	$-3.7	$-4.9	$-6.1	$-7.0	$-7.7
United States	10.0	13.6	16.0	10.4	12.0	9.1
European Community	0.5	1.5	2.7	1.9	2.6	2.7
Hong Kong	2.2	2.5	3.4	3.7	4.8	7.1
Asean*	0.4	0.6	0.7	1.2	2.4	2.8
Overall	10.6	15.6	19.0	10.9	13.9	12.5

*Brunei, Indonesia, Malaysia, the Philippines, Thailand and Singapore.

Source: Taiwanese Government

As pressure from Washington intensified in the late 1980s for action on the trade front, government officials in Taipei began to voice increasing concern about Taiwan's widening deficit with Japan. They readily admitted that Taiwan's expanding world exports were a major cause of the bigger imbalance because this growth pulled in more imports from Japan, but policymakers in Taipei also faulted Japan for not buying more Taiwanese-made products.

To help boost demand in Japan for imports from Taiwan, the Ministry of Economic Affairs' trade promotion arm, the China External Trade Development Council, initiated a variety of activities. These included staging product exhibits in Japan, sending missions there to contact corporate purchasing offices and local chambers of commerce, and inviting Japanese buyers to visit Taiwan. In early 1990 President Lee Teng-hui asked his economic affairs minister to lead a high-level export mission to Japan. Apparently not sharing Taipei's concerns about the mounting bilateral trade imbalance, Tokyo responded coolly to this initiative. Referring to its policy of no contacts between high-level officials of the two governments, Tokyo refused to issue a visa for the minister.

This decision added to the strains in the Taiwan-Japan economic relationship. So did a number of politically linked developments last year. Anti-Japanese feelings arose in Taiwan when some Japanese right-wing activists built a lighthouse on one of the Senkaku Islands in the East China Sea, a site over which both Taipei and Beijing have made territorial claims. Moreover, in line with Tokyo's new policy of monitoring more closely the entry into Japan of people suspected of being illegal foreign workers, the Ministry of Justice began to require visas of Taiwanese, including people in Japan just to change planes. Previous regulations had allowed Taiwanese to stay in Japan up to 72 hours without a visa; that allowed travelers arriving at Haneda airport to make connections with international flights departing from Narita. As it turned out, the visa policy change coincided with Taipei's decision to allow Taiwanese residents to visit family members on mainland China; thus, it affected the growing number of Taiwanese using Haneda and Narita airports on their way to and from China.

Taipei Takes Action

Irritated by Tokyo's lack of movement in dealing with the expanding bilateral trade imbalance, Taipei announced a series of measures in June 1990 designed to tackle the problem both directly and indirectly. Among other moves the government urged Taiwanese companies to shift foreign sourcing from Japan to other countries; called on Japanese firms manufacturing in Taiwan to export their output to Japan; tightened customs-clearance and inspection procedures for goods coming in from Japan; conditioned new Japanese investment in the manufacturing sector on technology transfers and/or export requirements; and made it more difficult for Japanese business representatives to get visas. Taipei also initiated a review of its trade policy toward Japan with an eye toward imposing unilateral restrictions on Japanese-supplied imports.

By September the Taiwanese government had identified 282 specific products imported mainly from Japan (see Table 6) that it wanted local manufacturers to buy from other countries. This past January Taipei requested Japanese-affiliated automotive manufacturers operating in Taiwan to draft plans to increase exports to Japan to 10 percent of their total output within three years and to expand their local content. Taipei also asked Japanese trading houses to submit three-year sales projections that included commitments to expand exports of Taiwanese products to Japan.

Table 6: Taiwan's Dependency on Imports from Japan, 1989*

(im millions of dollars)

	Total Imports	Imports from Japan	Dependency Ratio
Machinery and Equipment (62 items)	$1,059	$969	91.5%
Parts and Components (103 items)	2,564	2,286	89.2
Industrial Materials (73 items)	1,046	947	90.6
Consumer Goods (44 items)	492	449	91.4
Total	52,248	16,027	30.7

*Products that Taiwanese companies are urged to buy from non-Japanese sources.

Source: Taiwanese Government

Japanese government officials have noted that some of the measures outlined by Taipei appear to violate international trade rules as represented by the General Agreement on Tariffs and Trade. But since Taiwan is not a GATT member and the diplomatic channels are missing through which Tokyo normally would protest the punitive trade actions of another government, Tokyo has no formal way to pressure Taipei to rescind its package of anti-Japan measures.

Taiwanese officials long have complained about the lack of a formal framework for resolving trade disputes with Japan -- an absence magnified in their view by the multiple channels available to Tokyo to work out problems with Washington or Seoul. They point out that South Korea, which also runs a sizable deficit in trade with Japan, has had several high-level opportunities over the last year or so to press Japan for change, including two meetings between President Roh Tae Woo and Prime Minister Toshiki Kaifu and a South Korea-Japan ministerial-level meeting last November. Some Taiwanese officials have suggested that Taipei should try to raise the bilateral trade imbalance issue at late July talks between government ministers of Taiwan and South Korea and then ask Seoul to push Tokyo to increase imports from both South Korea and Taiwan.

Private-Sector Initiatives

Although formal government ties are nonexistent, the business communities of Japan and Taiwan have held annual meetings since 1973. The deterioration of the business atmosphere formed the common concern of Japanese and Taiwanese private-sector representatives at their December 1990 conference. Both groups fully understood that Taipei's Japan-targeted policies not only could hurt Japanese exporters and investors but eventually could harm Taiwanese manufacturers because of their heavy dependence on equipment and parts supplied from Japan.

The business communities of both Japan and Taiwan agreed that the bilateral trade imbalance had to be addressed from a realistic, long-term perspective. In response to Taiwanese private-sector requests, more than 150 Japanese businessmen participated in a trade mission to Taiwan in May. In addition to organizing meetings in three major Taiwanese cities, the mission held a series of seminars addressing the willingness of Japan's business community to cooperate in improving Taiwanese competitiveness through technology transfers and the dissemination of market information. Representatives of the Ministry of International Trade and Industry as well as officials from the semigovernmental Japan External Trade Organization and the Manufactured Imports Promotion Organization joined the mission as advisers.

Taipei officials expressed a hope that corporate Japan would help transform the Taiwanese economy from export dependent to domestic demand-led. A six-year, $300 billion economic development plan launched this year by Taipei is designed to foster more balanced economic growth. Much of the money will be used to improve Taiwan's economic infrastructure, but building up the parts supplier base also is a major objective. Japanese companies figure prominently in this part of the plan since their technical and financial assistance will be needed. That involvement, the government hopes, will lead to greater parts exports to Japan. Even if it does not, the substitution of locally made parts for imported products should reduce the Japan-Taiwan trade imbalance.

Some analysts have interpreted the May business mission as a Japanese effort to save face. These observers saw Taipei's June 1990 actions as a warning signal to draw Tokyo's attention to the problem of the bilateral trade imbalance. But, they surmised, once Japan's corporate sector demonstrated its interest in tackling trade problems between the two economies, Taipei sooner or later would end its Japan-targeted measures.

Private-Sector Investment Cooperation

Both the new development plan and the trade mission highlighted the central role of foreign technical assistance in the structural transformation of the Taiwanese economy. Japanese companies already are providing help in this area through their direct investments in Taiwan. Pushed by the yen's post-1985 appreciation and the growing labor shortage at home and pulled by Taiwan's rapid economic growth, the amount of Japanese money invested in Taiwan jumped in the second half of the 1980s. Last year, according to Taiwanese statistics, Japanese investment totaled $826.8 million, up 29.1 percent from 1989's figure and equivalent to 35.9 percent of overall foreign investment (see Table 7). Japan has been the top investor in Taiwan since 1988. By the end of 1990 its cumulative total exceeded that of the United States. Of last year's addition, $513 million -- 62 percent -- went into the manufacturing sector, particularly electronics ($172 million), metals and fabricated metal products ($110 million) and chemicals ($87 million).

Table 7: Foreign Direct Investment in Taiwan, 1980-90

(in millions of dollars)

	Value				Share		
Year	Total	Japan	United States	Overseas Chinese	Japan	United States	Overseas Chinese
1980	$465.9	$86.0	$110.0	$222.5	18.5%	23.6%	47.8%
1985	702.4	145.2	332.7	41.7	20.7	47.4	5.9
1986	770.3	253.5	138.4	64.8	32.9	18.0	8.4
1987	1,418.7	399.2	414.0	195.7	28.1	29.2	13.8
1988	1,182.5	431.8	134.7	121.3	36.5	11.4	10.3
1989	2,418.2	640.5	343.0	177.2	26.5	14.2	7.3
1990	2,301.7	826.8	540.3	220.1	35.9	23.5	9.6
Cumulative 1952-90	13,251.6	3,682.4	3,291.0	1,953.7	27.8	24.8	14.7

Source: Taiwanese Government

Taiwanese firms also concluded 105 technical assistance contracts with Japanese companies in 1990, a number exceeding the combined total of contracts signed with American firms (50) and European businesses (30). Much of the recent growth in Japanese technical assistance has been in the electronics and the metalworking industries. Among the reasons many Taiwanese cite for their preference for Japanese affiliations are a concern with high quality, appropriate technology, marketing prowess and after-sale service.

Taiwan's rapidly rising labor costs increasingly detract from its desirability as a site for textiles and other labor-intensive products. Nevertheless, other factors, such as geographical proximity to Japan, relatively low inflation rates, an increasingly developed industrial infrastructure and a large pool of skilled labor, still make Taiwan an attractive investment place for Japanese manufacturers, especially producers of medium-technology products.

A major concern of Japanese investors and importers selecting overseas business partners is a firm's ability to produce a quality product at a competitive price and deliver it on schedule. Although some Japanese companies still complain about the quality of Taiwanese products, others acknowledge that improvements have occurred. The rising level of investment in Taiwan's manufacturing sector and technical assistance to local suppliers implies that Japanese producers see Taiwanese companies as potentially good business partners.

Taiwanese companies increasingly are trying to become part of Japanese manufacturers' supplier networks. Their goal is to collaborate with small and midsized Japanese firms supplying big manufacturers in Japan. Although parts shipments from Taiwan to Japan still are fairly limited, a number of Taiwanese companies work closely with Japanese firms elsewhere in Southeast Asia. For example, Taiwanese parts makers with plants in Philippine or Indonesian industrial estates often supply Japanese manufacturers with operations in the same complexes. Taiwanese investors also fill a gap in the supply chain of less-developed Southeast Asian countries by helping provide parts to Japanese firms manufacturing there.

From the perspective of Japanese industry, ties with Taiwanese firms offer the prospect of expanded business opportunities in Southeast Asia where Taiwanese companies traditionally have had strong relations with overseas Chinese. In addition, since political rapprochement between Beijing and Taipei remains a possibility and because many Taiwanese are interested in doing business with mainland China, Japanese businessmen and their Taiwanese counterparts see each other as potential partners on the mainland. Taiwanese firms view their success in forming supplier relationships with Japanese firms in Southeast Asia as a key to improving international competitiveness and, in turn, increasing direct shipments to Japan.

One indication of the prospects for expanded collaboration between Japanese and Taiwanese companies in Southeast Asia is the recent jump in Taiwanese direct investment in Thailand, Malaysia, the Philippines and other countries belonging to the Association of Southeast Asia Nations. Last year Taiwanese investment in Asean countries for the first time exceeded the amount of money going into the United States (see Table 8).

Table 8: Taiwanese Foreign Direct Investment, 1984-90

(in millions of dollars)

	Value						Share	
			Asean					
Year	Total	United States	Total	Thailand	Malaysia	Philippines	United States	Asean
1984	$39.3	$30.5	$6.5	$0.2	$1.2	n.a.	77.8%	16.6%
1985	41.3	35.7	3.9	2.6	n.a.	n.a.	86.4	9.3
1986	56.9	46.0	8.1	5.8	n.a.	$0.1	80.8	14.2
1987	102.8	70.1	16.1	5.4	5.8	2.6	68.2	15.6
1988	218.7	123.4	59.1	11.9	2.7	36.2	56.4	27.0
1989	931.0	508.7	210.2	51.6	158.6	66.3	54.6	22.6
1990	1,552.2	428.7	567.3	149.4	184.9	123.6	27.6	36.6

Source: Taiwanese Government

Outlook

With Taiwan playing an increasingly important role in the world economy, Taipei is anxious to participate in international economic organizations. In January 1990 Taiwan applied for GATT membership. It also has expressed interest in joining the Asian Pacific Economic Cooperation group, made up of the Asean countries, South Korea, the United States, Japan, Canada, Australia and New Zealand (see JEI Report No. 32B, August 17, 1990). One advantage of Taiwan joining GATT is that it would give Tokyo and Taipei a forum for discussing bilateral economic problems. Beijing, however, also is seeking GATT membership as well as participation in APEC, and it is vehemently opposed to Taiwan receiving membership in any international organization. With this position in mind, Tokyo has not offered support for Taipei's attempts to join GATT.

Some observers argue, however, that as the post-Cold War political order takes hold in East Asia, Taipei and Beijing will be forced to review their relationship; such a move could result in both Taipei and Beijing gaining entry to international organizations. Furthermore, Great Britain's accord to return Hong Kong to China in 1997 could have a sweeping impact on relations since most economic exchanges between Taiwan and mainland China currently are carried out through Hong Kong. Analysts expect that as 1997 nears the governments on both sides of the Taiwan Strait will look for ways to make bilateral economic relations more transparent.

Recent moves by Seoul, which maintains diplomatic ties with Taipei but also seeks official relations with Beijing, could facilitate this development. As the host country of the next APEC meeting, South Korea has expressed an interest in inviting representatives from Beijing, Taipei and Hong Kong to participate in the talks. Tokyo has supported Seoul's initiative, saying it welcomed APEC membership for all three as long as each agreed to the others' simultaneous entry. If Taipei and Beijing agree to each other joining APEC and, possibly, GATT, the business environment in East Asia certainly would improve. That would set the stage for the expansion of regional economic cooperation.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

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NO. 28A

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FOREIGN LAWYERS IN JAPAN: A GROWING U.S. EXPORT

Summary

For 75 years prior to 1955 Japanese law permitted foreign lawyers to ply their craft in Japan but prohibited court-related activities. Formidable barriers to foreign lawyers were in place from 1955 to 1987, when new legislation authorized a restricted foreign presence. Since then about 100 foreign lawyers have received permission for a limited practice in Japan. The removal or softening of some of the restrictions governing foreign lawyers is a concern of the Office of U.S. Trade Representative because it considers ease of access to foreign lawyers in Japan to be a key means of facilitating complex international business transactions. The present restrictions create an asymmetrical situation, USTR officials believe; Japanese companies selling or investing in the United States have easy access to expert advice, but their U.S. counterparts do not have similar opportunities in Japan. The aim of the current negotiations is to redress these asymmetries.

Foreign Lawyers and Regulation of the Legal Sector

Negotiations to open the Japanese legal sector, which have been ongoing since the early 1980s, have been especially difficult. One reason is that they confront the Japanese notion of law and the role of lawyers. A more mundane explanation is that changes in the scope of foreign lawyers practicing in Japan could endanger the entrenched interests of Japanese lawyers; they have been granted a partial monopoly over a narrowly defined area of legal practice -- litigation and court-related activities. Restrictions on foreign lawyers are part of the regulatory framework controlling the more general practice of law.

But regulation is not an isolated activity. The structure of regulation itself is determined by a rough balance among the conflicting desires of those who stand to gain and lose from the power of the state to restrict behavior and transfer wealth. Since the Meiji Restoration and the evolution of the Japanese legal system, those balances have shifted. The role of the foreign lawyer likewise has changed.

The same laws that have defined the practice of domestic lawyers in Japan regulate foreign lawyers there, too. Legislation in 1893 established the first framework for lawyers following adoption of the 1889 Meiji Constitution. This law coined the term bengoshi for the Japanese practitioner, a translation of the English title "barrister." Until now bengoshi primarily have performed the role of a trial lawyer; the monopoly extended to members of the profession assign to bengoshi exclusive rights to provide legal assistance to parties in formal court proceedings or in actions that could crystallize into a court case. The 1893 statute permitted foreign lawyers to handle all other kinds of legal affairs as well as court proceedings related to cases involving aliens and international transactions.[1]

The authority permitting foreign lawyers to provide commercial counseling outside the areas reserved for bengoshi was undisputed. Major revisions to what is known as the Bengoshi Law in 1933 and 1949 altered only slightly the provisions affecting foreign lawyers. The 1949 law, drafted during the American occupation, permitted foreigners to be recognized and admitted as bengoshi if they could pass the required examinations on Japanese law; it also licensed foreign lawyers in a category limited to cases involving aliens and foreign law. Under the 1949 licensing procedures 68 foreign lawyers -- mostly American -- were admitted to practice, but only two passed the examination on Japanese law. According to some experts, the formal granting of licenses did not expand or contract the permitted areas of practice but rather altered the process of application and approval.

Starting in the 1950s some Japanese international lawyers contended that the 1949 provisions were demanded by the occupation authorities and were a sharp break with the past.[2] Most legal scholars, however, rebut this view and argue that the postwar legislation merely continued on the main lines that had begun even before the Meiji Constitution.[3] Then in 1955 the Diet repealed the articles in the Bengoshi Law that permitted the licensing of foreign lawyers; those who had been admitted previously were allowed to continue to practice under a grandfather clause as jun-kaiin, or "quasi-members" of the bar.

[1] John O. Haley, "Redefining the Scope of Practice Under Japan's New Regime for Regulating Foreign Lawyers," Law in Japan, XXI, 1988, p. 21.

[2] An example of this view is in Keiichi Tadaki, "The Gaikokuho Jimu Bengoshi System: Circumstances of Acceptance and Scope of Practice," Law in Japan, XXI, 1988, pp. 122-123.

[3] Haley, op. cit., p. 21.

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Nichibenren (Japan Federation of Bar Associations) campaigned to further prevent foreigners from being able to give legal advice that fell outside the already controlled and narrow scope of court cases and litigation. The organization interpreted the 1955 legislative changes as prohibiting all legal advice by foreigners, partly on the grounds that all matters, at some future time, may become the subject of litigation. In 1973 Nichibenren issued a set of standards that urged an expansion of the kinds of activities reserved for bengoshi; among these were legal counseling and other activities unrelated to trial practice. These standards also characterized all foreigners not admitted to the Japanese bar as "unqualified aliens."[4] Convinced to adopt the policy implicit in the Nichibenren standards, the government cooperated by denying or restricting visas to American attorneys traveling to Japan in the mid-1970s for business purposes.

The Bengoshi Law, however, was not the only potential gateway for American lawyers. The Treaty of Friendship, Commerce and Navigation between the United States and Japan, which became effective in 1953, permitted several kinds of legal activities. First, U.S. individuals and companies received national treatment in Japan, meaning they could perform services that Japanese citizens who are not bengoshi may perform. Actions that would not violate the Bengoshi Law, for example, included business and financial consulting or the preparation of contracts. Second, Article VIII of the treaty stated that U.S. companies and individuals in connection with the operation of their enterprises and those in which they have a financial interest shall be permitted to engage ". . . attorneys, agents, and other specialists of their choice . . . regardless of the extent to which they may have qualified for the practice of a profession within the territory of Japan. . . ." Such attorneys or specialists, however, could not become involved in court cases or other activities clearly reserved to members of the bar. Although the author of the foreign lawyer sections of the Bengoshi Law supported the U.S. interpretation of the treaty in numerous law journal articles, the Ministry of Foreign Affairs continued to refuse to issue visas to American attorneys until the issue was resolved in the mid-1980s.

Article VIII also barred nationality as a requirement for practicing a profession if an applicant met all the qualifications applicable to nationals; Japanese would be treated similarly in the United States under the treaty's reciprocity provisions. The Senate, however, ratified the treaty without the reciprocity clause because it wanted to maintain nationality restrictions on lawyers in the United States. Diet members subsequently attempted to close off the unreciprocated rights of Americans in Japan; some have argued that the 1955 amendment barring foreign lawyers was at least in part a response to the reciprocity issue.[5]

U.S. nationality requirements collapsed, however, in a 1973 Supreme Court ruling that such requirements infringed the 14th Amendment of the U.S.

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[4] "Standards Concerning the Prevention of Non Attorney Activities by Foreigners, 1972," quoted in Tadao Fukuhara, "The Status of Foreign Lawyers in Japan," The Japanese Annual of International Law, No. 17, 1973, p. 36.

[5] Tadaki, op. cit., p. 124.

Constitution.[6] A substantial number of foreigners, including Japanese, subsequently qualified to practice in the United States by passing state bar examinations. In addition, New York state adopted liberalized rules in 1974 for licensing foreign lawyers as legal consultants in foreign law without examination. This shift in the weight of reciprocity made Japan the lagging partner of the treaty.

By the mid-1970s the explosive growth of Japanese trade resulted in a growing demand for international legal skills and increased foreign attention to the tightening restrictions on foreign lawyers. U.S. law firms attempting to service their international clients found themselves increasingly hampered in their ability to operate in Tokyo. Visa restrictions, formal Nichibenren complaints against foreign lawyers' activities plus informal pressures on Japanese lawyers who cooperated with foreign lawyers made the situation ripe for converting a legalistic quarrel into an international dispute. A small group of American lawyers in international practice urged the U.S. government to become involved formally and directly in removing or reducing Japan's restrictions on their activities. The target of their attention was a complex legal framework influenced by and protective of Nichibenren members.

Structure of Legal Practice

The relatively small number of lawyers in Japan results entirely from government regulation, with strong support from Nichibenren. Undergraduate law faculties in the major universities annually graduate more than 30,000 students. These graduates can enter the management ranks of corporate or government bureaucracies, apply their legal expertise by joining the legal departments of major companies, or take the bar examination -- the first step toward qualification as a bengoshi.

Since 1970 more than 20,000 applicants have taken the national law examination each year; applications reached a peak of about 30,000 in the late 1970s (see Table 1). Of these, only about 500 have been permitted to pass and enter the two-year full scholarship program of the Legal Training and Research Institute, administered by the Supreme Court and the only law school authorized to train bengoshi. The 2 percent success rate stands in sharp contrast to the 66 percent who pass a bar exam in the United States.[7] Moreover, the average age of people passing the Japanese exam has been rising for the past 15 years; in 1990 the average was 28-plus. This indicates applicants spend about six or seven years at cram schools, often after repeated attempts at taking the examination. For those who do not pass, and even for those who pass after repeated tries, this represents substantial investments in lost time and forgone income.

The number of people permitted to enter the Legal Training and Research Institute bears little relation to notions of supply and demand; the level has been set administratively since around 1965. Training focuses almost solely on the development of trial skills. Graduates include not only those who become bengoshi but also future judges and public prosecutors.

[6] In re Griffiths, 413 U.S. 717 (1973).

[7] Arthur J. Alexander and Hong W. Tan, Case Studies of U.S. Service Trade in Japan (Santa Monica, California: Rand Corp., September 1984), p. 57.

Table 1: Persons Taking and Passing Japanese National Legal Examinations, 1950-90

Year	Number of Applicants	Number Passing	Percentage Passing	Percentage First-Time Passers*
1950	2,806	260	9.3%	17.8%
1955	6,347	250	3.9	22.7
1960	8,363	366	4.4	18.4
1965	13,644	563	4.1	18.5
1970	20,160	519	2.6	10.4
1975	27,791	482	1.7	6.9
1980	28,656	545	1.9	4.1
1985	23,855	482	2.0	3.3
1986	23,904	538	2.3	n.a.
1987	24,690	526	2.1	n.a.
1988	23,352	535	2.3	n.a.
1989	23,202	523	2.3	n.a.
1990	22,900	506	2.2	n.a.

*Percentage of first-time passes includes people 22 years or younger.

Source: Ministry of Justice, Statistics Concerning the Legal Examination, 1990.

With the growth in the size and the complexity of Japanese society, Ministry of Justice officials in charge of personnel matters have been concerned about a growing paucity of trained legal personnel and a shrinking number of candidates wishing to be judges. Accordingly, MOJ increased the number of applicants to the institute to 600 in 1991 and proposed that 700 be accepted in 1993, with perhaps additional increases in the future.[8]

Part of the Justice Ministry's concerns stems from the number of Japanese lawyers moving into the field of international law and away from the more traditional areas of litigation (see below). The Tokyo pages of the Martindale-Hubbell Law Directory, for example, provide an imperfect but useful measure of the growing number of Japanese lawyers specializing in the international field. The English-language directory is comprised of entries paid for by the listed firms; it is aimed primarily at the international community. Since 1970 the number of international legal specialists has grown more than fivefold (see Table 2). Roughly 10 percent of the lawyers in the Tokyo area are engaged in international law.

After completing the course at the training institute, the successful graduate must join one of the regional bar associations before being allowed to practice. The bar is an autonomous body authorized by law to license and supervise the bengoshi community. Because of its independence and authority, Nichibenren has a great deal of persuasive and coercive power over its members and the Ministry of Justice.

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[8] "Reform Eyed to Up Bar Exam Success," The Japan Times, February 5, 1991, p. 2.

Table 2: International Lawyers and Law Firms in Tokyo, 1966-90

Year	Number of Firms	Number of Lawyers*
1966	15	103
1970	17	130
1974	24	187
1978	37	274
1982	47	334
1990	76	685

*Excludes patent attorneys, legal counsel and foreigners who are not members of the Japanese bar.

Source: Martindale-Hubbell Law Directory

The kind of work performed by the international specialist stands in sharp contrast to that of the traditional bengoshi. Lawyers outside of Tokyo spend about 85 percent of their time on civil court cases; the average Tokyo practice is a little lower at 75 percent. Non-Tokyo and Tokyo lawyers spend only 5 percent and 10 percent of their time, respectively, on nondispute-related matters. As bengoshi gain seniority and experience, they focus an even greater share of their time and energy on court-related work; more than 80 percent of this work, even in Tokyo, is for individuals or small and medium-sized businesses.[9] The traditional practice of a Japanese lawyer, therefore, is quite different from the commercial advice and complex transactions handled by Japanese lawyers specializing in international matters and their active, problem-solving approach to client interests.

The traditional bengoshi also has a different orientation toward the law than the typical American lawyer or international legal specialist. A bengoshi often feels a greater sense of obligation toward society as a whole than to the narrow interests of his clients. Japanese bengoshi, American lawyers in Tokyo, Justice Ministry officials and foreign business executives in Japan all have raised these differences in legal orientation as impediments toward greater liberalization. One analyst underlined the importance of such differences, saying, "[T]he least discussed but most fundamental threat created by the entry of foreign lawyers is the potential for redefinition of the very nature and structure of the Japanese legal profession."[10] Yet a foreign business adviser in Tokyo, while noting particular instances of the traditional bengoshi approach to the law, tellingly observed that "the lack of serious competition among the small number of bengoshi permits them to indulge in this lofty role."[11]

[9] Michael K. Young, "Foreign Lawyers in Japan: A Case Study in Transnational Dispute Resolution and Marginal Reform," Law in Japan, XXI, 1988, p. 102.

[10] Ibid., p. 105.

[11] John E. Perry, Jr., "A Consumer's View of the Market for Legal Services in Japan," Law in Japan, XXI, 1988, p. 180.

These competing, but not necessarily exclusive, views of the Japanese legal situation offer two explanations for Nichibenren's reluctance to allow the entry of more foreign lawyers or a loosening of the restrictions on their practice: (1) preservation of the returns inherent in a monopoly -- including high incomes and the freedom to practice as desired, unperturbed by competitive pressures, and (2) maintenance of an approach to the law that places social welfare above client or personal interests. To assess the validity of these possible explanations it is necessary to determine whether incomes indeed are higher than might be expected in a more competitive environment; in other words, is there something worth protecting?

Incomes of Japanese Lawyers

The prima facie evidence suggests that having bengoshi status is valuable. The fact that thousands of individuals are willing to devote years to studying for the legal examination, taking and retaking it, with barely a 2 percent chance of passing suggests that the returns on this effort warrant the investment. Moreover, the fact that the annual growth rate in the number of lawyers in the international field has averaged about 9 percent over the past 20 years indicates even higher returns to this specialty within the legal field.

A 1987 study estimated the incomes of Tokyo lawyers from income tax information for the years 1964 to 1982. Combining the income data with biographical information from Nichibenren, the study calculated the real incomes of lawyers, taking account of such other factors that affect income as years of experience, education and firm size.[12] Demand for international specialists was linked to the sum of imports and exports; supply was defined as the total number of lawyers in international practice as well as the size of the group entering the specialty the same year as a given lawyer.

The results of these estimates for lawyers in their prime earning years are shown in Table 3 along with the real incomes of other professionals of the same average age. Domestic lawyers' incomes were equivalent to those of their most successful peers in alternative occupations, except for top medical officers. (The results generally were consistent with, but about 25 percent lower than, a Nichibenren income survey for 1979.[13]) Lawyers in international practice did very well indeed, with incomes considerably higher than any of the comparison groups. Their Y26 million average income in 1982 was equivalent to $104,200 at that year's average exchange rate of Y249.08=$1.00. Table 3 also indicates, however, that the real incomes of international specialists had declined quite substantially over the years studied.

These results are consistent with the presence of monopoly returns in international practice and their erosion over the years. They also are

[12] Hong W. Tan and Arthur J. Alexander, Entry Restrictions and Japanese Lawyers' Incomes in International Legal Practice (Santa Monica, California: Rand Corp., May 1987).

[13] Kahei Rokumoto, "The Present State of the Japanese Practicing Attorneys" (unpublished paper, Tokyo University Law faculty, 1984). Mr. Rokumoto did not analyze possible biases from the partial response to the survey; biases usually raise reported incomes.

Table 3: Incomes of Tokyo Lawyers in Domestic and International Practice and Other Professionals*

(real incomes in 1982 terms in thousands of yen)

	1964	1970	1976	1982
Domestic Lawyer	Y6,128	Y10,717	Y8,701	Y6,768
International Lawyer	41,547	29,795	35,055	25,964
Hospital Director	n.a.	n.a.	17,053	18,794
Chief of Medical Department	n.a.	n.a.	9,938	10,928
Head of Research Institute	n.a.	n.a.	6,470	6,883
University Professor	n.a.	n.a.	5,487	6,026

*Age 50 or older.

Source: Nonlawyers income, Japan Statistical Yearbook; lawyers income, Hong W. Tan and Arthur J. Alexander, Entry Restrictions and Japanese Lawyers' Income in International Legal Practice (Santa Monica, California: Rand Corp., May 1987), p. 14.

consistent with the high, but not extraordinary, returns calculated for the study's random sample of Tokyo lawyers in domestic practice. The high inflation-adjusted incomes for international lawyers at the start of the study suggests that with the elimination of competition from foreign lawyers in 1955, the gap between the demand for legal advice on international business and the supply of lawyers able to provide this help initially grew as the foreign activities of Japanese companies expanded at quite rapid rates. This gap created an incentive for domestic lawyers already admitted to the bar to invest in the training and the experience necessary to enter the lucrative international specialty. However, the resulting expansion of Japanese lawyers in the international field then, as would be expected, eroded the high returns since demand did not grow even more rapidly.

Japanese lawyers in international practice turn out to have been the most active lobbyists for maintaining the restrictions on foreign lawyers.[14] Statistically estimated equations in the previously mentioned study found that real incomes fell proportionately with the number of specialists but rose at only half the rate of growth in demand.[15] The downward pressure on incomes from the expansion in the number of practitioners offers a clue to understanding the fervent desire of those already in the international specialty to prevent more lawyers from entering. The latent pool of trained and experienced-foreign lawyers posed a real threat to the high incomes of Japanese specialists, who had seen, as a group, their incomes in the early 1980s plunge from the high disequilibrium returns of an earlier period.

[14] Young, op. cit., p. 104 and Rexford L. Coleman, "Some of the Underlying Politics of the Dispute Involving Foreign Attorneys Under the Japanese Attorney's Law and a Plea for Future Accommodation," Law in Japan, XXI, 1988, pp. 72-73.

[15] Tan and Alexander, op. cit., pp. 25-27.

The only moderately high incomes of lawyers in domestic practice also may explain the drop-off in the number of people taking the bar examination. The rate of return on a legal education for a domestic lawyer was higher in 1978 than for the average college graduate but only if the prospective lawyer took five years or less to pass the legal exams.[16] If a law school applicant spent seven years retaking the tests, the return was barely equal to that of the average graduate. Moreover, the attractiveness of a career in law rapidly diminished as the average time to pass the exam expanded to more than seven years. The practice of international law, however, remained competitive -- even for the seven-year candidate.

That people in domestic legal practice have not earned even higher incomes than those observed above is partly explainable by the large number of legal practitioners who are not bengoshi. As noted earlier, the bengoshi's monopoly extends over a rather restricted area of practice -- actual or potential litigation. Patent attorneys, tax attorneys, legal scriveners, administrative scriveners and the internal legal staff of major companies provide a great deal of the legal advice typically given by lawyers in the United States. As shown in Table 4, the total number of legal workers in Japan is far higher than the usually cited figure, which covers only the small number of bengoshi. Using a definition of lawyer that corresponds more closely with U.S. usage yields a ratio of one legal worker in Japan per 1,100 people instead of the figure of one to 10,000 when just the number of bengoshi are counted. This approach also reduces the contrast with this country, where there is one legal worker per 505 Americans. And it helps account for the modestly high value of domestic law incomes in Japan.

Table 4: Persons Doing Legal Work in Japan, 1982

Occupation	Number
Judges	2,700
Public Prosecutors	1,170
Bengoshi	12,230
Company Legal Staff	1,300-6,000
Judicial Scriveners	14,570
Administrative Scriveners	30,120
Patent Attorneys	2,600
Tax Attorneys	40,860
Total	105,550-110,250
Japanese Population	118,100,000
Population Per Legal Worker	1,071-1,119

Source: Michael Young, "Foreign Lawyers in Japan: A Case Study in Transnational Dispute Resolution and Marginal Reform," Law in Japan, XXI, 1988, p. 116.

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[16] Tan and Alexander, op. cit., p. 18.

The Japanese economy has witnessed the deregulation of finance and banking plus a surge in offshore investment and trade since 1982, the cutoff for the previously mentioned study. Have international legal incomes continued to decline with the flow of additional specialists into the field, or has the growth of demand countered the negative forces of expanded supply? A Nichibenren survey of the salaries of new hires in 1990 indicated that the long-term decline noted earlier has been reversed. That means internationally oriented bengoshi have even more to lose today than they did in the 1970s should negotiations succeed in opening Japan's legal market still further.

First-year salaries for international specialists were Y10 million ($74,100 at Y135=$1.00). Domestic law first-year salaries were Y7 million ($51,900). Applying the equations used to adjust the 1964-82 data (including changes in consumer price levels), the starting salary of an international lawyer in 1990 would have been only Y1.7 million ($12,600) if the earlier relationship had remained valid. Evidently something drastic has changed in the past 10 years. Most observers attribute the change to the explosive growth of both outbound and inbound capital flows, a development that the 1987 study's simple demand measure of exports plus imports would have failed to capture.

Pressure from Cultural Views of Law

The preservation of monopoly incomes obviously has shaped Nichibenren's stance on foreign lawyers. What about the other proposed explanation for its position, that the bar association is trying to protect Japanese legal culture? Within the legal community a small number strongly and actively back the traditional bengoshi approach to the law; they have helped international specialists block moves that would threaten the interests of both the average bengoshi and the international specialist. Several American scholars of Japanese law have argued more broadly that the present regime favors all the major players and harms only a more diffuse public with little voice in the debate.

What Japanologists have called the "consensual myth" corresponds to most Japanese accepting as fact such ideas as: litigation is too disruptive, lawyers are especially quarrelsome, and disputes between reasonable people can be settled without courts and lawyers.[17] In summarizing this ideology, commentators inevitably stress the importance to Japanese of preserving harmony and hierarchy. A powerful result is the protection of the Japanese legal system from the incursions of foreigners who would bring with them alien notions of legal ideology and disrupt the existing order. Some scholars go on to observe that these widely shared and deeply held views also promote the narrow interests of the involved parties. For example, the government emphasizes the consensual and nonlitigious nature of Japanese tradition and thereby thwarts challenges to "national, social and economic policies through the courts," and as a result, helps "concentrate power over such policies in the hands of government and business leaders."[18]

[17] J. Mark Ramseyer, "Lawyers, Foreign Lawyers, and Lawyer-Substitutes: the Market for Regulation in Japan," Harvard International Law Journal, XXI, 1986, p. 506.

[18] J. Mark Ramseyer, "Japan's Myth of Nonlitigiousness," The National Law Journal, July 4, 1983, p. 36.

Lawyers benefit from the policies proceeding from this ideology through high incomes and the ability to promote lofty social goals. Businesses are not harmed by the shortage of lawyers and court delays because they have their own legal staffs and both the skilled specialists and the deep pockets to negotiate settlements. Even if some elements within the government would prefer to negotiate access for foreign lawyers, Nichibenren can afford to oppose these views, especially when the bar association's cooperation is needed on other matters -- as in the 1980s when the government was trying to revise the criminal code.

Analysis of Japanese court cases is consistent with the argument that government measures introduced in the 1930s and in the postwar period have capped the level of legal activity in Japan below that seen in many other countries and below that experienced earlier.[19] What is less clear is whether the public-at-large prefers this situation to the alternative of a more law-minded and litigious society. The fact that legal incomes are maintained at high levels may be a consequence of a widely shared ideology as well as something desired by members of the legal profession. In this case the classic strategy of a profession attempting to maintain its preferred status through barriers to entry also is consistent with cultural norms that are promoted actively by important sectors of society.

Rapid changes in the economic environment are likely to have an impact on the legal ideology. The urbanization of society, the consequent decline of social sanctions, the increased complexity and volume of economic transactions as well as the internationalization of business have reduced the forces suppressing litigiousness.[20] Pressures on the legal system from crowded court calendars, lengthy delays and inadequate legal representation add to the forces for change.

Important figures in the Justice Ministry are contemplating policies to modernize the legal system, perhaps more in line with the British approach. In the midst of this yeast-like culture foreign interests are promoting a review of the regulations affecting foreign lawyers. These regulations, however, are part of a larger pattern, the evolving Japanese legal system.

Negotiations: 1974-87

The growth of demand and opportunities in the Japanese market in the 1970s occurred concomitantly with the visa problems and other harassments of foreign lawyers. In response, some of the large, internationally oriented American law firms sought changes in the Japanese situation. Also anxious for change were American trainees in Japanese law firms, young members of the U.S. bar who had gained experience in international law and wished to remain in Tokyo but who saw no route of advancement open to them. The American Bar Association approached Nichibenren in 1974 to open discussions. After eight years of unfruitful meetings the ABA enlisted the support of the U.S. government. Even on a government-to-government basis little movement occurred until mid-1985 when Japan's seventh package of market access initiatives (the Action Program) devoted a brief passage to foreign lawyers, indicating that the Bengoshi Law soon would be amended to resolve problems, such as those outlined by the ABA. Intensive negotiations ensued over the next two years on the details of the required legislation and implementing regulations.[21]

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[19] John Owen Haley, "The Myth of the Reluctant Litigant," Journal of Japanese Studies, Summer 1978, p. 372.

[20] Hideo Tanaka (ed.), The Japanese Legal System (Tokyo: University of Tokyo Press, 1976), p. 263.

Some American specialists on Japanese law thought reversion to the authority provided under the Friendship Treaty could resolve many of the problems by persuading the Ministry of Foreign Affairs to resume issuing visas in the usual manner. These experts believed that neither Nichibenren nor public prosecutors legally could attack practicing foreign lawyers, provided they did not encroach on the litigation turf clearly reserved for bengoshi. The Friendship Treaty approach, however, was rebuffed by Nichibenren and Japanese negotiators, although it is unclear whether the Office of the U.S. Trade Representative, the lead U.S. agency in the negotiations, fully adopted the rationale as a negotiating option.[22] The strategy of ignoring the Friendship Treaty path drew vigorous criticism after the first round of negotiations. The critics argued that a solution embedded in new legislation predictably would result in Japanese authorities deferring to the more activist international lawyers in the Japanese bar in establishing the terms for admission.[23]

U.S. negotiators continued, however, to seek changes in the law that would establish clearly the right as well as the bounds of foreign legal practice. According to the chief American negotiator, the process was made difficult by the "clash of legal cultures," the weak authority of the Japanese government over Nichibenren (a condition imposed by the American occupation authorities), individual state laws in the United States versus the unified Japanese law, and the absence of sustained high-level attention.[24]

In 1984 Nichibenren had brought to the table a comprehensive proposal for resolving the various issues surrounding foreign lawyers; at the time U.S. international lawyers nixed the terms.[25] Nevertheless, as Japanese and American negotiators hammered out the details of the proposed legislation, both sides essentially adopted Nichibenren's main points. The Diet adopted the compromise proposed in May 1986. Between then and the measure's effective date of April 1, 1987 a second phase of negotiations focused on the implementing rules and regulations. Many of the seemingly onerous restrictions in the law were eased considerably by understandings reached in the subsequent discussions. Remaining problems, however, resurfaced again in 1990 discussions (see below).

[21] Glen S. Fukushima, "The Liberalization of Legal Services in Japan: A U.S. Government Negotiator's Perspective," Law in Japan, XXI, 1988, p. 7.

[22] Fukushima, op. cit., p. 15.

[23] Haley (1989), op. cit., p. 25.

[24] Fukushima, op. cit., pp. 8-9.

[25] Ramseyer (1986), op. cit., pp. 206-207.

The 1986 Foreign Lawyer's Law

The 1986 law defined the scope of foreign lawyers' practice in Japan and imposed certain qualifications and restrictions. Among the major points were:

- The title to be used by the foreign lawyer is gaikokuho jimu bengoshi, roughly translated as "foreign office-work attorney," which is close to the British meaning of "solicitor."

- The basic function of the foreign attorney is to carry out legal business concerning the laws of the country of his or her primary qualification. Because admission to the bar in the United States is on a state-by-state basis and because both governments had agreed to state-by-state reciprocity for American lawyers in Japan, the country of primary qualification was one of the most contentious issues. The agreed outcome was for U.S. lawyers to qualify in Japan according to their state of license and then apply for "designation" for other jurisdictions. An American negotiator has termed approvals of such designations as "virtually automatic."[26]

- Foreign lawyers are prohibited from specific categories of activities. They cannot represent clients in Japanese domestic courts, criminal cases, and lawsuits or administrative proceedings conducted by a foreign court or administrative agency other than those of the country of primary qualification. Neither can a foreign lawyer draw up a "notarial deed" or serve documents (such as a subpoena) for a foreign court or agency or handle cases dealing mainly with real property in Japan.

- Applicants are required to have five years of experience in their home jurisdiction. Some American trainees strenuously objected to this provision because most of their experience had been gained in Japan rather than in the United States. Subsequent interpretations allowed two years of their Japanese experience to count in the five-year requirement, but only if they were employed as trainees at the time the new law went into effect.

- Reciprocity is granted on a state-by-state basis in the case of American lawyers. Eleven American jurisdictions have set the stage for reciprocity by permitting the licensing of foreign legal specialists.

- A bengoshi may employ a licensed foreign lawyer or a trainee, but a foreign lawyer may not hire a bengoshi or operate a partnership with joint distribution of fees. Certain restricted office-sharing arrangements, though, are permitted.

- A foreign lawyer must join a local bar association and submit to its disciplinary jurisdiction.

Various regulations control many other details of practice; for example, they limit the foreign lawyer to a single office and provide detailed guidance regarding the name of the office and even the format and the size of type on signs and business cards. (The individual's name, for example, must come first and be at least as large as the firm's name. A familiar story in Tokyo involves one American firm's bowling team where league shirts were checked by authorities for the proper designation of the firm's name.)

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[26] Fukushima, op. cit., p. 14.

Operating Under the 1986 Law

Within four years of the law's effective date, 98 foreign lawyers had registered in Japan. These included 73 from the United States, 23 from Great Britain, and one each from France and Germany (see Table 5). Among the U.S. registrants were two Japanese citizens who had passed bar examinations in U.S. jurisdictions and who subsequently applied as foreign lawyers in Japan. Of the 98 registered foreign lawyers, 19 have left Japan since their registration.

Table 5: Registered Foreign Lawyers In Japan, April 1991

Home Jurisdiction	Total Number Registered	Left Japan
United States	73	15
New York	42	11
California	18	
Hawaii	2	
Texas	1	
New Jersey	1	
District of Columbia	9	4
United Kingdom	23	4
France	1	
Germany	1	

Source: Ministry of Justice

Most of the remaining foreign lawyers find the existing restrictions more of a nuisance than important prohibitions on their behavior. Such views, however, may be biased because those who would be most affected are unlikely to open offices. In particular, small law firms or solo practitioners continue to face formidable barriers from regulatory procedures that are less onerous to large international firms. The application procedure, for example, requires the applicant to provide proof of a Japanese residence, office lease, financial plan, financial capability and malpractice insurance -- all of which require substantial investments prior to the start of actual business.

Law firms wishing to assist foreign businesses dealing with problems of market access and investment in Japan find that restrictions on hiring *bengoshi* who can provide advice on Japanese law continue to put them at a disadvantage. Foreign law firms limited to advising clients on the laws of their home jurisdictions are involved primarily in assisting Japanese businesses seeking access to U.S. markets. Some U.S. firms with several years' experience in Tokyo claim that this problem is overstated since they can confer with local *bengoshi* just as they do in the United States with lawyers in other jurisdictions. Nevertheless, it is this point that transforms the foreign lawyer issue into a trade problem and that is at the center of continuing U.S.-Japan negotiations.

Ongoing Negotiations

In early 1990, after three years of experience under the new law, both governments resumed negotiations to resolve remaining issues. Washington believed that the 1986 legislation was a significant first step but not the final move. The U.S. strategy was to allow experience to dictate the next steps. Five working-level negotiations held in 1990 focused on five points U.S. negotiators wanted revised: (1) the prohibition on partnerships with bengoshi; (2) the prohibition on employing bengoshi; (3) the inability of foreign lawyers to use their firm name as their primary designation; (4) the five-year experience requirement; and (5) restrictions on participation in arbitration proceedings. (See JEI Report No. 2B, January 18, 1991, for detailed discussion of these points.)

USTR officials see the partnership and the employment issues as the most troubling obstacles affecting broader U.S. trade interests. The employment restriction is viewed as benefiting Japanese exports and foreign investment. Permitting closer arrangements between foreign and Japanese lawyers would facilitate foreign business transactions in Japan by providing expertise on domestic law through a firm interested in understanding the needs of foreign clients.

The Japanese side feels that it can be flexible on all the issues except the ones involving employment and partnership. The problem over the arbitration complaint is tied up with the overhaul of the Japanese arbitration system, which will take time to complete. U.S. negotiators point out what they see as an anomaly in that foreigners can act as arbitrators but cannot represent clients in arbitration proceedings.

Negotiators from the Ministries of Foreign Affairs and Justice have said they would like to settle all the outstanding issues in a flexible manner as a way of promoting broader national interests. Nichibenren, however, appears to be resisting further change. It sees the Japanese legal profession as gaining nothing and losing much from flexible solutions: an undesirable change in the composition of legal practice, an emphasis on client-oriented advice, a chipping away at protected preserves and high incomes, a demeaning status from being the employees of foreigners, and the opening of a back door for foreigners to engage in domestic legal advice. Unlike the process in most other areas of Japanese legislation where the responsible ministry drafts laws, bengoshi themselves traditionally have written legislation affecting their legal practice. This independence from government further complicates transpacific negotiations.

Nevertheless, there are signs of change within the Japanese legal community. At least one Tokyo bar association is recommending changes along the lines sought by the United States; articles in legal journals also are advocating similar moves. In addition, negotiators from both sides are seeking technical solutions that would satisfy the main U.S. goals while respecting the core of Nichibenren objections -- for example, the provision for some kind of "joint office." For the moment active, formal negotiations are in abeyance while the Japanese side attempts to arrive at a solution acceptable to domestic players. The time may be ripe now, however, for pushing through a compromise since demand is high, incomes are rising, and no special problems have arisen during the four years in which foreign lawyers have operated under the new law.

Conclusions: Slow Progress and Hidden Agendas

As in so many negotiations between the United States and Japan, progress often appears to be glacial and the results microscopic. Yet over the long run major gains have been achieved. From the time that the American Bar Association first sat down with its Japanese counterpart, 12 years passed before new legislation was forthcoming. The 1986 law, however, did achieve many of the main changes sought by the United States. Nearly 100 foreign lawyers have been licensed to practice in Japan, and more apply every month. Legitimate complaints have been raised on both sides that the approach was mistaken and the outcomes injurious to certain personal and national interests, but by and large there appears to be considerable satisfaction over the results. Still, those results are incomplete; progress continues to be difficult, if not elusive.

Part of the difficulty lies in the hidden agendas of the participants; they actively debate the issues on the table but maneuver directly or indirectly to achieve often hidden and sometimes even subconscious objectives. Many Americans, for example, really do want to change the Japanese legal culture and make what Japanese may regard as the spirit of the law in terms of guidance and understanding more transparent and law-oriented; they also would prefer to see greater emphasis on due process. At the same time many Japanese participants fear a foreign legal invasion and possible dominance in an area where they still are relatively inexperienced. Others are anxious about competitive pressures, whether from foreign or domestic sources; as one economist noted a century ago, the chief benefit from monopoly is a quiet life. In addition, lawyers on both sides prefer higher incomes to lower incomes, although no participant seems willing to be explicit about such a common human motivation. But with persistence, the forces of international supply and demand have become more free, and that has benefited both countries. Ongoing negotiations could enhance these results.

For further information, contact Arthur J. Alexander.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

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Kaifu Puts In Strong Showing At London Summit

Prime Minister Toshiki Kaifu, who suffers from domestic criticism that he is a weak leader, apparently was every bit the major power standard-bearer at the July 15-17 summit in London of the leaders of the seven major industrial democracies, judging by the communiques. Mr. Kaifu played an important role in securing language in the concluding political and economic statements that reflected Tokyo's position on aid to the Soviet Union as well as the Japanese government's contention that the ban on rice imports should be maintained for reasons of "food security." Perhaps most important, according to chief cabinet secretary Misoji Sakamoto, the results of the three-day meeting of the heads of the United States, Japan, Great Britain, Canada, France, Germany and Italy reflected Tokyo's "global perspective" on the political and economic issues confronting the summit participants.

Some Japanese observers point to Soviet President Mikhail Gorbachev's inability to win a clear pledge of financial assistance from the seven major industrial democracies as a victory, of sorts, for Japan, the United States and Great Britain. Holding firm to their position at last year's Houston summit, Tokyo, Washington and London urged that the major powers hold off on granting aid until Moscow has made more progress in instituting market adjustments and in democratizing its political system. President Bush and Mr. Kaifu had reaffirmed their agreement on this issue at a presummit meeting in Kennebunkport, stake in Bull's U.S.-based Bull HN Information Systems Inc. subsidiary for a 4.7 percent stake in the French computer maker. Prime Minister Cressor was concerned that the equity link eventually might imperil Bull's independence, but this concern was allayed when NEC agreed to allow the government to buy back its shares at any time. In another area of intense competition -- advanced television -- cooperation also is evident. In late June the telecommunications ministers of France and Japan agreed to push development of equipment that would translate Japan's high-definition television signals into a format that can be used by French HDTV broadcasts.

The commitment of both Brussels and Tokyo to better relations will not have to wait for a test. While Japan's trade surplus with the United States has been declining, its trade balance with the EC has tilted decidedly into the black as January-June 1991 exports rose by nearly 20 percent and imports shrank by more than 3 percent (see following article). Trade in cars poses particularly thorny problems. The community continues to press Tokyo to accept voluntary limits on car exports to the EC for a transitional period after 1992. Tokyo grudgingly accepts the need for interim controls but rejects any attempt by the EC to count cars produced by the European subsidiaries of Japanese companies as "imports." Other issues, such as EC antitrust and antidumping policies as well as the role of foreign firms in EC research and development programs, will provide additional tests of the new cooperation agreement.

Jon Choy

Japan's Trade Surplus Rises Again

Japan's worldwide dollar-denominated trade surplus jumped 33.9 percent in the April-June period compared to the figure for the comparable period of 1990, the second straight quarter of year-to-year growth after seven quarters of contraction (see Table). That news normally might presage a rhetorical barrage from across the Pacific. Yet this time Washington is likely to be relatively quiet. The dollar-denominated second-quarter surplus with the United States not only showed a 15.1 percent drop but was at its lowest level for the second quarter since 1983. The Japanese figures suggest that when the Department of Commerce releases the U.S. trade statistics for the first half of 1991 in August the deficit with Japan will be down again.

If Washington could take modest satisfaction from the latest Japanese trade numbers, Brussels could not; Japan's April-June imbalance with the European Community jumped 66.5 percent over a year earlier. Although Japan-EC trade is less than two-thirds that of Japan-U.S. commerce, Japan's $7 billion surplus with the EC in the second quarter was larger than that with the United States, reversing the typical pattern. In addition, the just-released data show that Japan's surplus with the rest of the world tripled in the April-June period compared to last year, although exports and imports in this category remained relatively equal.

Although the geographic distribution of Japan's trade imbalances may be troublesome for Tokyo, other aspects of the latest data paint a less gloomy picture for those policymakers hoping to avoid a sustained increase in Japan's global imbalances. As in the past, the most recent figures were influenced heavily by fluctuations in the yen-dollar exchange rate. Both imports and

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$209,151	19.1%	$126,408	-2.4%	$82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1989	275,175	3.9	210,847	12.5	64,328
1990	286,948	4.3	234,799	11.4	52,149
1989: I	68,227	13.2	51,142	14.9	17,085
II	67,602	3.7	51,292	8.5	16,310
III	69,595	3.6	53,048	12.3	16,547
IV	69,751	-3.5	55,364	14.6	14,387
1990: I	66,705	-2.2	54,383	6.3	12,322
II	67,232	-0.5	53,954	5.2	13,278
III	72,189	3.7	56,547	6.6	15,642
IV	80,822	15.9	69,914	26.3	10,908
1991: I	76,384	14.5	61,820	13.7	14,564
II (p)	73,979	10.0	56,207	4.2	17,772

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y35,290	-15.9%	Y21,551	-30.7%	Y13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1989	37,823	11.4	28,979	20.7	8,844
1990	41,457	9.6	33,855	16.8	7,602
1989: I	8,705	12.9	6,516	14.6	2,189
II	9,222	13.0	6,997	18.2	2,225
III	9,911	11.0	7,547	20.2	2,363
IV	9,985	9.3	7,919	29.4	2,067
1990: I	9,766	12.2	7,941	21.9	1,825
II	10,449	13.3	8,392	19.9	2,057
III	10,651	7.5	8,364	10.8	2,287
IV	10,592	6.1	9,159	15.7	1,433
1991: I	10,190	4.3	8,251	3.9	1,939
II (p)	10,223	-2.2	7,765	-7.5	2,458

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$80,456	23.3%	$29,054	12.6%	$51,401
1987	83,580	3.9	31,491	8.4	52,090
1988	89,634	7.2	42,037	33.5	47,597
1989	93,189	4.0	48,246	14.8	44,943
1990	90,322	-3.1	52,369	8.5	37,953
1989: I	22,726	14.4	11,599	15.0	11,127
II	22,997	6.4	12,064	15.4	10,933
III	24,117	4.6	12,462	16.8	11,655
IV	23,347	-7.0	12,120	12.0	11,227
1990: I	21,661	-4.7	12,753	9.9	8,908
II	20,938	-9.0	12,861	6.6	8,077
III	22,933	-4.9	12,729	2.1	10,204
IV	24,790	6.2	14,025	15.7	10,765
1991: I	22,324	3.1	13,247	3.9	9,077
II (p)	20,282	-3.1	13,426	4.4	6,856

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y13,564	-13.0%	Y4,918	-20.9%	Y8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988	11,487	-5.4	5,388	17.6	6,099
1989	12,816	11.6	6,632	23.1	6,184
1990	13,057	1.9	7,586	14.4	5,471
1989: I	2,899	14.1	1,478	14.6	1,421
II	3,139	16.0	1,648	25.9	1,491
III	3,436	12.2	1,773	25.0	1,663
IV	3,342	5.2	1,733	26.4	1,609
1990: I	3,171	9.4	1,862	26.0	1,309
II	3,254	3.7	2,000	21.4	1,254
III	3,384	-1.5	1,885	6.3	1,498
IV	3,249	-2.8	1,838	6.1	1,411
1991: I	2,978	-6.1	1,767	-5.1	1,211
II (p)	2,802	-13.9	1,854	-7.3	948

exports traded at an average rate of Y138.2=$1.00 in the April-June quarter compared to Y155.5=$1.00 a year earlier. The effect was to inflate the dollar value of exports, while leaving imports, which are more likely to be priced in dollars, relatively unaffected. Thus, the overall dollar imbalance widened even though exports dipped slightly in volume terms while imports rose modestly; that left the price-adjusted surplus somewhat smaller.

The effect of exchange rate differences on Japan's July-September trade figures is likely to be less since the yen averaged approximately Y148 to the dollar in the third quarter of 1990; to date the exchange rate has been running in the high Y130 range, and there is little to suggest that the average of the Japanese currency for this quarter will move out of the Y130 range. This argument indicates that, other factors equal, the imbalance will show a smaller year-to-year swing in the current quarter.

The regional distribution of Japan's third-quarter trade surplus, however, will depend on the courses traveled by the economies of the United States, Europe and Japan. If the U.S. economy recovers, as it appears to be doing, Japanese exports could rise, putting upward pressure on the bilateral imbalance. The strength of the Japanese economy will influence heavily the volume of imports from Europe. Japanese analysts attributed the rise in the April-June surplus with the EC to a sharp drop in European imports that reflected uncertainty among Japan's well-to-do, who buy a substantial share of expensive European goods, such as cars. Conversely, some Japanese analysts feel that the pattern of demand for Japanese goods in Europe resembles an "L," a shape that is supposed to represent stable demand in the face of higher prices. But if "L" stands for "large," it could refer to the size of the negotiating table that might be required if future quarterly trade numbers resemble those from the April-June period.

Douglas Ostrom

House Hears Varying Views On U.S.-Japan Relationship

A panel of the House Committee on Foreign Affairs took a close look July 16 at the U.S.-Japan relationship and heard a range of recommendations on how Washington should approach the alliance. Rep. Stephen Solarz (D, N.Y.), chairman of the subcommittee on Asian and Pacific affairs, opened the hearing by noting the importance of looking carefully at "new American views of Japan and its international behavior, primarily because such views can affect the shaping of policy." The subcommittee set out, Rep. Solarz said, to consider whether the post-World War II partnership "has lost its usefulness and is becoming the victim of an irreversible crisis." Joining in the questioning were Rep. Robert Lagomarsino (R, Calif.) and the delegate from American Samoa, Eni Faleomavaega (D), who acknowledged, "No one really knows how to define the new framework of Japanese-American relations clearly."

A cautious view of current U.S.-Japan relations came from Kevin Kearns of the Economic Strategy Institute, a Washington, D.C.-based research organization; he expressed his "strong belief that neither our security nor our economic relationship with Japan is on sound footing and that a thorough review of America's Japan policy is necessary to begin to set things right." Mr. Kearns, a former State Department foreign service officer, more than a year ago

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JAPAN-MIDDLE EAST RELATIONS ENTERING A NEW ERA?

Summary

While Japan continues to depend on the Middle East for about 70 percent of its crude oil needs, the end of both the Iran-Iraq war and the Iraqi occupation of Kuwait have wrought changes in Japanese and Middle Eastern views of bilateral economic and political relations. On the economic side oil will remain the bedrock of bilateral trade but exchanges of other goods and services are becoming more prominent, as are investment and aid. In step with Tokyo's desire to play a role in international affairs commensurate with its economic strength, Japanese foreign policy toward the region is in a period of reassessment and change.

Background

Until the early 1970s Japan's relations with the Middle East could best be described as "detached." Political and cultural ties were weak, and even economic contacts -- mainly in the form of Japanese purchases of crude oil -- were indirect, as Japanese oil companies prefered to contract for deliveries with foreign oil companies rather than establish their own presence in the Persian Gulf. This detachment insulated Japan from much of the historical enmity and political tension that plagues American or European relations with the region. Moreover, Japan's renouncement of the use of external military force and its policy of maintaining evenhanded diplomatic ties to most nations in the region gave Japan a neutral cast in affairs there.

The 1973 Arab-Israeli War and the threat by the newly formed Organization of Petroleum Exporting Countries to cut off oil supplies motivated Tokyo to abandon its bystander position. Maintaining access to Mideast oil rapidly shifted from an implicit to an explicit tenet in Tokyo's policy toward the region. Japanese government officials began calling regularly on Middle Eastern counterparts, and Japanese firms began dealing directly with companies and governments of the region.

For the remainder of the 1970s and throughout the 1980s the goal of maintaining friendly relations with oil producers, and thus access to oil, generally was second only to good relations with the United States on Japan's foreign policy agenda. These two priorities often were in harmony. For example, both Washington and Tokyo put a premium on the unrestricted transport of oil in and out of the Persian Gulf. This meant that the two allies cooperated on discouraging regional conflicts and curtailing the Soviet Union's influence in the gulf. On several occasions, however, Tokyo's need for oil put it at odds with Washington, most notably in relation to Iran and the Arab-Israeli conflict. Nevertheless, Tokyo emerged from the 1980s having pursued with general success a balancing act between its top foreign policy goals, generally following but at times defying U.S. policy in the region (see JEI Report No. 9A, March 4, 1988).

The 1990s, however, have brought even greater demands on Tokyo -- calls from within and without for Japan to bear international responsibilities equal to its economic strength, which had grown tremendously over the previous decade. Beyond expanded foreign aid, this new burden includes more independent, actively involved policies in foreign affairs and trade that promote higher goals than profits for Japanese businessmen or Japan's economic survival. Tokyo's new list of policy goals goes beyond its traditional aims of facilitating economic development and resolving disputes nonviolently to include cleaning up the environment, reducing the global arms race and fostering political democratization. Iraq's August 1990 invasion of Kuwait, the subsequent multinational military campaign to free Kuwait and the creation of a stable postconflict political and economic order in the Middle East have served as a crucible to test Japan's newly proclaimed mettle. Today, Japan-Middle East political and economic relations clearly are in a state of flux, complicated by uncertainties arising from post-Cold War adjustments.

Economic Links

In the midst of swirling changes two facets of bilateral trade remain steadfast: Japan's trade deficit with the Middle East and oil's dominant position. Even these two factors, though, are not immutable. Over the past 20 years, for example, the level of economic interdependence has shifted, mostly in Japan's favor, and the pattern of Japan's trade by country and by product has begun to show some interesting developments.

Overall Trade - Japan's trade with the Middle East is linked tightly to the price of crude oil. After expanding rapidly in the 1970s due to sharply higher oil prices, Japan's dollar-denominated two-way trade with the Middle East tapered off in the 1980s as oil prices dropped and the yen strengthened against the dollar (see Table 1). The price relationship still holds, however, as shown by the data for 1989 and 1990. The spike in oil prices caused by

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Table 1: Japan's Trade with the Middle East, 1970-90*

(in millions of dollars and percentage of total)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Exports												
Food	$10.3	1.9%	$68.7	1.2%	$213.1	1.6%	$118.1	1.0%	$35.2	0.4%	$48.1	0.5%
Raw Materials	3.3	0.6	20.0	0.4	26.1	0.2	47.4	0.4	49.9	0.6	18.1	0.2
Light Industry Products	206.9	37.7	1,043.6	18.6	2,480.3	19.0	2,053.5	18.1	1,487.3	19.0	1,485.8	15.3
Heavy Industry Products	328.3	59.8	4,453.9	79.6	10,312.3	78.8	9,082.6	80.1	6,199.6	79.1	8,074.1	83.3
Chemicals	14.1	2.6	112.5	2.0	256.8	2.0	168.6	1.5	186.6	2.4	283.1	2.9
Metals	118.0	21.5	2,043.6	36.5	2,723.7	20.8	1,775.5	15.7	968.6	12.4	1,061.8	11.0
Nonelectric Machinery	31.0	5.6	652.5	11.7	1,681.2	12.9	2,047.4	18.1	1,263.9	16.1	1,666.6	17.2
Electric Machinery	87.4	15.9	554.3	9.9	2,517.0	19.2	2,191.9	19.3	1,377.2	17.6	1,792.9	18.5
Transportation Equipment	60.7	11.1	974.1	17.4	2,822.5	21.6	2,548.0	22.5	2,086.8	26.6	2,905.2	30.0
Precision Instruments	17.1	3.1	116.9	2.1	311.1	2.4	351.2	3.1	316.6	4.0	364.5	3.8
Other	0.5	0.1	12.5	0.2	51.1	0.4	35.3	0.3	60.8	0.8	66.1	0.7
Total Exports	549.3	100.0	5,598.7	100.0	13,082.8	100.0	11,336.9	100.0	7,833.0	100.0	9,692.0	100.0
Imports												
Food	12.6	0.5	37.1	0.2	45.3	0.1	66.1	0.2	142.2	0.6	154.3	0.5
Raw Materials	60.3	2.7	68.0	0.4	64.2	0.1	103.0	0.4	180.6	0.8	148.7	0.5
Crude Oil	1,860.2	81.8	14,886.9	92.0	38,097.7	86.7	24,243.0	82.6	14,975.6	65.0	22,164.2	70.6
Petroleum Products	241.2	10.6	475.9	2.9	2,288.7	5.2	1,686.9	5.7	4,045.7	17.6	4,607.9	14.7
Liquefied Gas	67.1	2.9	578.5	3.6	3,175.8	7.2	2,781.1	9.5	1,798.8	7.8	2,403.7	7.7
Manufactured Products	30.0	1.3	126.1	0.8	263.0	0.6	434.3	1.5	1,826.9	7.9	1,856.2	5.9
Other	1.3	0.0	5.5	0.0	14.1	0.0	40.1	0.1	59.3	0.3	60.6	0.2
Total Imports	2,273.4	100.0	16,178.0	100.0	43,948.8	100.0	29,354.6	100.0	23,029.1	100.0	31,395.5	100.0
Trade Balance	-1,724.1		-10,579.3		-30,866.0		-18,017.7		-15,196.1		-21,703.5	

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Iraq's August 1990 invasion of Kuwait boosted the size of Japan's import bill, leading to a sharp reversal of the downward trend in the country's trade deficit with the Middle East.

Just as oil continues to account for the majority of Japan's energy supply, the Middle East remains the principal source of Japanese oil imports (see Table 2). Tokyo has made progress toward cutting its dependence on oil for energy but will find it difficult to reduce this ratio below 50 percent as the nation pursues an improved standard of living. (For a full analysis of Japan's energy situation, see JEI Report No. 23A, June 21, 1991.) Although diversification of oil supplies is a long-standing goal of government and business in Japan, the Middle East with its huge share of global reserves was able to win back some Japanese business in 1989 and 1990, partly because OPEC's difficulty in regulating the production of its members helped keep prices relatively low until the late summer of 1990.

Table 2: Japan's Dependence on Crude Oil and the Middle East, 1970-90

	Crude Oil's Share of Japan's Energy Supply	Middle East's Share of Japan's Oil Imports
1970	70.8%	86.6%
1975	73.3	78.2
1980	65.8	73.3
1985	55.2	69.8
1986	55.2	68.5
1987	56.9	67.5
1988	57.3	67.6
1989	57.5	71.0
1990	54.8	71.5

Sources: Ministry of International Trade and Industry and Japan Petroleum Association

Oil's impact on trade shows up in other ways. The Middle East's share of Japan's exports and imports exhibits the same price-induced bulge during the 1970s and between 1989 and 1990 as seen above (see Table 3). From the other side of the transaction the price effect is less clear (see Table 4), perhaps because the yen's value strengthened between 1985 and 1988, although Japan's importance as an export market for the Middle East continues. What is visible from both tables, however, is that the relative importance of the other as a trade partner generally has declined. This trend has important political ramifications that are explored below.

Tables 3 and 4 also highlight the basic buyer-seller imbalance between the partners. With relatively small populations but huge natural resources, Middle Eastern nations can absorb a relatively limited proportion of Japan's manufactured exports but can supply a significant share of its input requirements. Resource-poor but industrially strong Japan faces the opposite situation. The bilateral trade imbalance, therefore, naturally tilts in the Middle East's favor.

Table 3: Middle East's* Share of Japan's Trade, 1970-90

(percentage of Japan's exports or imports)

	Exports	Imports
1970	2.8%	12.0%
1975	10.0	28.0
1980	10.1	31.3
1985	6.5	22.7
1986	4.5	14.4
1987	3.7	13.4
1988	3.2	10.4
1989	2.8	10.9
1990	3.4	13.4

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Table 4: Japan's Share of Middle East's* Trade, 1970-89

(percentage of Middle East's exports or imports)

	Exports	Imports
1970	27.2%	6.9%
1975	20.0	13.2
1980	18.9	13.1
1985	25.5	12.7
1986	19.8	11.8
1987	18.6	10.0
1988	17.1	9.1
1989	17.0	8.3

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Composition of Trade - Beneath the veneer of oil's domination, the bilateral trade picture reveals several interesting features. After multiple expansions in the 1970s Japanese sales of heavy industrial products to the region have waned more than waxed since 1980 (Table 1). This probably reflects the completion of major infrastructure projects plus the saturation of the small Middle Eastern markets for some important consumer goods, such as televisions and similar electronics products as well as cars. It also may reflect declining

Japanese price competitiveness, particularly between 1985 and 1988 when the value of the yen increased sharply against the dollar and other currencies.

On the import side growing purchases of petroleum products and liquefied natural and/or petroleum gases have accompanied the gradual development of refineries in the Middle East and the liberalization of Japan's energy import policies. Saudi Arabia and Kuwait, in particular, have been pushing into downstream processing to add value to their exports. To accommodate this new capacity Japan and other oil-consuming nations have been cutting domestic refining capacity and have opened their doors to imports of such products as gasoline, jet fuel and kerosene.

On a country basis the sharp demarcation in the volume of Japanese trade between oil producers and nonoil producers is not a surprising phenomenon (see Table 5). Trends within each group also are visible. Among oil producers, for example, Iran and Kuwait played relatively less important roles in Japan's trade in 1990 than 15 years ago, while Saudi Arabia and the United Arab Emirates became more important. Among nonoil-producing countries the variability of trade with some, such as Egypt, is striking. Trade with Israel and Turkey, in contrast, have grown gradually but steadily.

Shifts in the relative importance of Japan's Middle Eastern trading partners come into sharper focus when each nation's trade is analyzed by product (see Tables 6 and 7). The changing fortunes of Iran and Saudi Arabia form the two ends of the spectrum, the former descending from Japan's top regional trading partner as the latter replaced it. Israel's relative decline in the pecking order is not a result of reduced trade; rather, it is a reflection of the trade boom enjoyed by oil-producing Arab countries. As will be discussed below, many Japanese firms generally have followed the Arab-led boycott of Israel, one of the reasons for the relatively low volume of bilateral trade.

Aid - Under a formula adopted in the 1970s Tokyo informally targeted 10 percent of its total official development assistance for the Middle East; this rule continued to guide Japanese foreign aid allocations through the 1980s. As part of its efforts to play a more responsible international role in the 1990s, however, Tokyo has downgraded the geographic formula and is putting greater emphasis on need-based criteria. According to the latest available data, Middle Eastern countries suffered a sharp drop in Japanese ODA disbursements in 1989, falling from $583 million or 9.1 percent of 1988's total to $368 million or 5.4 percent (see JEI Report No. 47A, December 14, 1990). The reason for the decline is not apparent. While the oil-producing countries of the region generally do not qualify for aid, the nonoil producers, such as Jordan, Yemen, Syria and Turkey, do. It is not surprising to find that Turkey (which accounted for an average 1.8 percent of total Japanese ODA in the 1987-88 period), Egypt (1.6 percent) and Syria (0.9 percent) account for the majority of Japan's Middle East aid.

The Persian Gulf conflict presented Tokyo with an opportunity to demonstrate its commitment to humanitarian and environmental issues. Since Iraq invaded Kuwait last August, Tokyo has pledged a total of $142.5 million to international relief organizations working in the Middle East, including the United Nations Disaster Relief Coordination Office, the International Committee of the Red Cross and the International Organization for Migration (see JEI Report No. 26A, July 12, 1991). Last month Japan also said that a portion of the

Table 5: Japan's Trade With Selected Middle Eastern Countries, 1970-90

(in millions of dollars and percentage of total trade with Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Iran												
Exports	$178.7	27.5%	$1,854.3	29.9%	$1,529.5	10.5%	$1,347.7	10.7%	$922.4	10.3%	$1,617.2	14.9%
Imports	995.3	42.1	4,977.8	30.1	4,101.0	9.2	2,505.8	8.4	1,792.3	7.7	3,460.1	10.9
Iraq												
Exports	15.9	2.4	818.8	13.2	2,169.5	14.9	1,305.6	10.4	490.7	5.5	251.4	2.3
Imports	0.2	0.1	395.9	2.4	4,339.1	9.7	621.5	2.1	1,214.5	5.2	910.9	2.9
Saudi Arabia												
Exports	83.8	12.9	1,350.8	21.7	4,855.7	33.4	3,890.0	30.9	2,763.2	30.9	3,341.2	30.7
Import	435.1	18.4	6,135.1	37.1	19,538.1	43.9	10,244.7	34.2	7,048.3	30.3	10,461.6	33.1
Kuwait												
Exports	94.4	14.5	367.2	5.9	1,272.9	8.7	1,536.1	12.2	670.8	7.5	397.9	3.7
Imports	308.3	13.0	2,011.7	12.2	3,457.6	7.8	1,162.3	3.9	2,338.9	10.0	1,711.4	5.4
United Arab Emirates												
Exports	0.0	0.0	420.2	6.8	1,355.9	9.3	1,164.4	9.2	1,296.2	14.5	1,550.3	14.3
Imports	0.0	0.0	1,774.0	10.7	8,190.4	18.4	8,916.3	29.7	6,051.4	26.0	9,084.6	28.7
Jordan												
Exports	11.0	1.7	67.6	1.1	193.7	1.3	190.1	1.5	66.6	0.7	61.8	0.6
Imports	0.1	0.0	11.8	0.1	21.7	0.1	28.1	0.1	23.5	0.1	27.4	0.1
Syria												
Exports	16.1	2.5	108.2	1.7	198.4	1.4	126.9	1.0	76.2	0.9	69.6	0.6
Imports	16.7	0.7	3.3	0.0	2.8	0.0	3.1	0.0	4.3	0.0	4.7	0.0
Egypt												
Exports	12.4	1.9	212.4	3.4	644.3	4.4	730.9	5.8	472.0	5.3	525.5	4.8
Imports	47.3	2.0	12.4	0.1	141.8	0.3	544.5	1.8	118.9	0.5	119.3	0.4
Israel												
Exports	20.0	3.1	73.2	1.2	108.6	0.7	170.4	1.4	317.5	3.6	509.0	4.7
Imports	27.8	1.2	89.4	0.5	227.0	0.5	214.9	0.7	757.9	3.3	879.4	2.8
Turkey												
Exports	13.4	2.1	39.6	0.6	194.6	1.3	433.6	3.4	377.3	4.2	991.6	9.1
Imports	28.4	1.2	42.3	0.3	39.4	0.1	60.5	0.2	238.1	1.0	267.3	0.8

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq, Iran, Egypt, Gaza, Cyprus, Libya, Sudan, Ethiopia, Djibouti and Somalia.

Source: Ministry of Finance

Table 6: Japan's Exports to Selected Middle Eastern Countries by Product Group, 1970-90

(in millions of dollars and percentage of exports to Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Light Manufactures												
Iran	$45.8	26.9%	$287.1	27.5%	$365.5	14.7%	$264.8	12.9%	$161.9	10.9%	$242.0	16.3%
Iraq	4.2	2.0	80.4	7.7	275.2	11.1	207.1	10.1	147.0	9.9	29.8	2.0
Saudi Arabia	39.8	19.3	265.2	25.4	840.6	33.9	731.4	35.6	489.6	32.9	534.3	36.0
Kuwait	29.6	14.3	112.9	10.8	331.5	13.4	199.9	9.7	117.5	7.9	76.7	5.2
United Arab Emirates**	26.4	12.7	111.7	10.7	313.8	12.7	346.0	16.7	349.0	23.5	326.8	22.0
Israel	4.9	2.4	8.3	0.8	13.4	0.5	25.4	1.2	27.7	1.9	32.6	2.2
Turkey	2.1	1.0	9.1	0.9	4.1	0.2	28.4	1.4	43.1	2.9	89.5	6.0
Chemicals												
Iran	5.1	36.1	59.6	53.0	111.8	43.5	47.3	28.0	42.9	23.0	129.9	45.9
Iraq	1.5	10.8	14.8	13.2	41.6	16.2	23.1	13.7	18.0	9.6	7.3	2.6
Saudi Arabia	1.1	8.3	10.7	9.6	28.6	11.1	38.1	22.6	49.3	26.4	51.3	18.1
Kuwait	1.2	8.1	4.5	4.0	17.2	6.7	13.3	7.9	9.9	5.3	10.5	3.7
United Arab Emirates**	0.5	3.8	3.0	2.6	16.3	6.4	13.3	7.9	13.4	7.2	20.8	7.4
Israel	1.8	13.0	7.0	7.4	12.9	5.0	9.3	5.5	16.5	8.9	22.6	8.0
Turkey	0.7	5.0	5.4	4.8	10.0	3.9	7.9	4.7	21.2	11.4	23.3	8.2
Metals												
Iran	63.1	54.2	866.9	42.4	511.1	18.8	392.6	22.1	192.1	19.8	384.7	36.2
Iraq	5.2	4.4	398.7	19.5	515.8	18.9	196.4	11.1	74.6	7.7	59.5	5.6
Saudi Arabia	11.5	9.8	378.6	18.5	978.2	35.9	583.9	32.9	334.4	34.5	282.4	26.6
Kuwait	6.9	5.8	67.7	3.3	188.9	6.9	205.5	11.6	83.6	8.6	46.3	4.4
United Arab Emirates**	8.9	7.6	111.2	5.4	256.6	9.4	143.2	8.1	85.2	8.8	122.4	11.5
Israel	3.5	3.0	27.1	1.3	13.3	0.5	9.5	0.5	9.5	1.0	11.3	1.1
Turkey	5.3	4.5	60.4	3.0	41.0	1.5	27.5	1.5	20.9	2.2	47.3	4.5
Nonelectric Machinery												
Iran	11.2	36.3	222.7	34.1	137.7	8.2	169.8	8.3	241.8	19.1	418.8	25.1
Iraq	1.2	3.7	134.1	20.5	430.9	25.6	357.8	17.5	102.6	8.1	56.4	3.4
Saudi Arabia	3.3	10.6	151.2	23.2	533.9	31.8	505.1	24.7	314.4	24.9	445.2	26.7
Kuwait	4.5	14.4	28.6	4.4	130.9	7.8	421.6	20.6	104.4	8.3	75.0	4.5
United Arab Emirates**	1.3	4.1	24.6	3.8	161.9	9.6	153.0	7.5	167.7	13.3	204.6	12.3
Israel	1.9	6.1	5.8	0.9	9.4	0.6	40.3	2.0	43.0	3.4	58.1	3.5
Turkey	3.5	11.3	31.3	4.8	104.2	6.2	137.0	6.7	116.6	9.2	263.0	15.8
Electric Machinery												
Iran	27.1	31.0	148.7	26.8	224.1	8.9	187.6	8.6	105.8	7.7	283.3	13.3
Iraq	2.4	2.7	53.7	9.7	345.6	13.7	146.0	6.7	80.3	5.8	40.5	2.3
Saudi Arabia	7.4	8.4	128.8	23.2	915.6	36.4	777.5	35.5	460.7	33.4	574.6	32.1
Kuwait	25.1	28.7	72.8	13.1	348.9	13.9	445.4	20.3	100.6	7.3	55.0	3.1
United Arab Emirates**	7.0	8.0	56.0	10.1	307.7	12.2	200.3	9.1	294.8	21.4	405.6	22.6
Israel	3.1	3.5	9.8	1.8	25.6	1.0	34.9	1.6	70.1	5.1	104.5	5.8
Turkey	2.9	3.3	21.6	3.9	27.9	1.1	147.9	6.7	128.0	9.3	234.5	13.1
Transportation Equipment												
Iran	11.1	18.3	226.9	23.3	126.7	4.5	213.8	8.4	108.7	5.2	133.0	4.6
Iraq	1.2	2.0	121.6	12.5	520.3	18.4	327.7	12.9	48.0	2.3	47.0	1.6
Saudi Arabia	14.8	24.3	356.9	36.6	1,246.1	44.1	1,044.4	41.0	980.3	47.0	1,318.1	45.4
Kuwait	23.8	39.2	62.9	6.5	213.4	7.6	197.5	7.8	220.5	10.6	114.6	3.9
United Arab Emirates**	4.7	7.7	92.7	9.5	244.7	8.7	240.1	9.4	297.4	14.3	364.2	12.5
Israel	0.4	0.7	2.0	0.2	17.6	0.6	26.2	1.0	106.9	5.1	217.2	7.5
Turkey	0.5	0.8	2.9	0.3	2.0	0.1	75.0	2.9	33.3	1.6	300.4	10.3

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.
**Figures for 1970 include Bahrain and Qatar.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Table 7: Japan's Imports from Selected Middle Eastern Countries by Product Group, 1970-90

(in millions of dollars and percentage of imports from Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Food												
Iran	$4.9	39.3%	$7.4	20.0%	$5.8	12.8%	$3.6	5.4%	$30.2	21.2%	$26.5	17.2%
Iraq	0.1	0.9	0.3	0.9	0.5	1.0	2.1	3.1	0.0	0.0	0.0	0.0
Saudi Arabia	0.3	2.7	0.1	0.3	0.0	0.0	1.0	0.1	0.0	0.0	0.0	0.0
Kuwait	0.5	3.9	1.2	3.1	1.6	3.5	3.6	5.5	9.2	6.5	3.9	2.5
United Arab Emirates**	1.8	14.0	0.0	0.0	0.0	0.0	9.7	14.7	3.6	2.5	0.7	0.4
Israel	0.0	0.0	5.7	15.3	6.7	14.8	14.8	22.5	19.5	13.7	34.8	24.5
Turkey	4.0	32.2	13.3	35.9	12.4	27.3	26.3	39.8	58.6	41.2	79.0	51.2
Raw Materials												
Iran	13.2	21.9	16.5	24.3	6.5	10.1	3.0	2.9	16.1	8.9	8.4	5.7
Iraq	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	0.1	0.1	0.0	0.0	0.2	0.2	27.7	26.9	51.2	28.3	44.0	29.6
Kuwait	1.6	2.6	0.7	1.0	3.6	5.5	9.3	9.0	9.8	9.0	3.9	3.7
United Arab Emirates**	0.1	0.1	0.0	0.0	0.8	1.3	0.0	0.0	14.2	7.9	13.9	9.4
Israel	1.1	1.8	3.4	4.9	1.6	2.5	1.5	1.5	0.0	0.0	0.0	0.0
Turkey	21.2	35.1	28.0	35.1	26.2	40.9	23.0	22.4	53.6	31.3	43.5	29.2
Crude Oil												
Iran	932.7	52.5	4,793.0	52.5	3,566.0	9.4	2,480.6	10.2	1,689.4	11.3	3,365.4	15.2
Iraq	0.0	0.0	0.0	0.0	4,277.6	11.2	616.4	2.5	1,199.3	8.0	894.8	4.0
Saudi Arabia	331.8	17.8	5,680.6	38.2	17,207.2	45.2	8,102.9	33.4	3,378.3	25.0	6,328.8	28.6
Kuwait	192.7	10.4	1,719.4	11.5	2,104.8	5.5	559.3	2.3	985.7	6.6	817.2	0.2
United Arab Emirates**	117.4	6.3	1,733.8	11.9	7,419.0	19.5	7,379.0	30.4	4,413.4	29.5	6,875.1	31.0
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum Products												
Iran	35.6	14.7	52.4	11.0	4[illegible]6.6	21.7	13.8	0.8	0.0	0.0	0.0	0.0
Iraq	0.0	0.0	6.7	1.4	58.4	2.6	0.0	0.0	8.7	0.2	15.1	0.3
Saudi Arabia	71.8	29.8	93.4	19.6	563.7	24.6	653.8	38.8	2,058.4	50.9	2,615.1	56.8
Kuwait	85.0	35.2	184.8	38.8	743.3	32.5	397.6	23.6	1,055.1	26.1	687.3	14.9
United Arab Emirates**	23.5	9.7	0.0	0.0	0.0	0.0	0.0	0.0	487.5	12.0	783.5	16.0
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liquefied Natural/Petroleum Gas												
Iran	0.0	0.0	98.6	17.0	23.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Iraq	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	31.0	52.2	360.3	62.3	1,763.4	55.5	1,324.0	47.6	768.2	42.7	1,159.2	48.2
Kuwait	28.3	47.8	105.6	18.3	602.2	19.0	187.9	6.8	206.9	11.5	147.3	0.2
United Arab Emirates**	0.0	0.0	0.0	0.0	746.4	19.5	1,155.3	41.5	753.2	41.9	1,011.1	42.1
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactured Products												
Iran	0.0	0.0	0.0	0.0	2.1	0.8	4.5	1.0	50.4	2.8	55.4	3.0
Iraq	0.0	0.0	0.1	0.1	0.8	0.3	0.2	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	0.0	0.0	0.0	0.0	0.1	0.0	117.7	27.1	406.6	22.3	271.8	14.6
Kuwait	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.1	70.2	3.8	47.6	2.6
United Arab Emirates**	0.0	0.0	0.0	0.0	4.6	1.8	52.6	12.1	356.2	19.5	390.9	21.1
Israel	26.7	89.1	80.2	63.6	218.6	83.1	197.6	45.5	729.6	39.9	838.1	45.2
Turkey	2.9	6.8	0.4	6.8	0.7	0.3	4.2	1.0	124.8	6.8	144.3	7.8

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.
**Figures for 1970 include Bahrain and Qatar.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

approximately $500 million it provided for additional peacekeeping efforts in the region would go for humanitarian aid (see JEI Report No. 27B, July 19, 1991). Another $1.1 million went to buy supplies for refugees streaming out of Kuwait and Iraq into Jordan. Some of Japan's contributions helped pay to fly approximately 1,800 of these refugees back to their home countries. Government and business also provided vehicles and housing materials worth an undisclosed amount to Iran to support refugee relief efforts there.

Although it took time to organize, Tokyo has given a total of $2.6 million to help clean up the oil spills and oil well fires resulting from the Persian Gulf War. A total of $1.5 million has gone to the International Maritime Organization to fight oil spills, including containment booms, absorbents and skimming equipment. The remaining $1.1 million is earmarked for a trust fund managed by the United Nations Environment Program to alleviate the long-term effects of the spills and the fires.

Tokyo made aid part of its direct response to the gulf conflict, another step in the evolution of its policy of using aid for strategic purposes. A total of $2 billion was pledged for the frontline states of Jordan, Egypt and Turkey to help them cope with economic losses incurred because of the multinational trade embargo against Iraq and Iraqi-occupied Kuwait. Turkey and Jordan received $700 million each, while Egypt received the remaining $600 million. The majority of funds took the form of loans for emergency purchases of commodities or to finance trade in vital items and to support specific projects, such as constructing factories.

As the economic impact of the conflict lingers, more Japanese foreign aid is likely to be channeled toward the Middle East. A $100 million commitment to Syria already has been inked, and further aid is expected to be forthcoming for Jordan and other low-income countries of the region. Reconstruction aid to Iraq is almost certain once Baghdad has met all United Nations' peace conditions; that money probably will go through multilateral organizations to avoid political frictions with Western allies. What is not yet clear is whether Tokyo will help with the reconstruction of Kuwait. Tokyo might find it difficult to provide aid to a country that boasted a per capita income of over $20,000 before the war and still has vast assets to tap. The devastation of Kuwait is unquestioned, however, and Kuwaiti officials have hinted that they will seek funds from all sources, including Japan. (This issue is explored more fully below.)

Investment - The Middle East traditionally has not been the focus of Japanese private foreign direct investment activity. The region, in fact, accounted for a mere 1.1 percent of total foreign direct investment as of March 1991 (see Table 8). This, in part, is a consequence of Japan's detached economic relations with the region; it also reflects regional tensions and conflicts, which drive up the risks for investors, Japanese or otherwise. Although the oil-rich countries do not need foreign direct investment since their oil revenues can cover domestic investment needs, nonoil-producing nations would like more Japanese investment; generally, however, they cannot attract it because they lack natural resources to develop, their domestic markets are small and their industrial and agricultural potentials are limited.

Some governments among the nonoil producers are trying to change this. Egypt, for example, has initiated a system of free trade zones to capitalize on

Table 8: Japan's Foreign Direct Investment in the Middle East, FY 1989-FY 1990

(in number of cases, millions of dollars and percent)

	FY 1988			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Kuwait	--	$32	--%	--	$26	--%	4	$1,441	0.5%
Iran	--	1	--	0	0	0.0	108	1,006	0.3
United Arab Emirates	2	6	--	0	0	0.0	47	441	0.1
Saudi Arabia	0	0	0.0	0	0	0.0	101	369	0.1
Bahrain	1	24	--	0	0	0.0	23	128	--
Other	2	3	--	1	1	--	57	45	--
Total	5	66	0.1	1	27	--	340	3,431	1.1

Source: Ministry of Finance

its abundant, inexpensive labor supply. Cairo also is privatizing state-owned enterprises and other government-run projects; over the next five years 71 state-owned companies will be put on the auction block, as will about 4,000 local operations. Six Japanese manufacturers and two financial firms presently have a toehold in the Egyptian market.

A joint venture between Suzuki Motor Co., Ltd. and an Egyptian conglomerate illustrates the problems facing foreign investors. Production of light delivery vehicles at Suzuki Egypt S.A.E. has grown steadily since the venture was launched in 1988, four years after the government barred imports of foreign vehicles. The joint venture suffers, however, from foreign exchange controls, high prices for imported parts, a devalued local currency (which amplifies import price hikes), weak regional exports and controls on domestic markets and prices. Cairo has some concerns, too, primarily because a network of local parts suppliers has not developed even though the final assembly plant has been in operation several years; the domestic content of the vehicles remains well under 50 percent. Not only are investments in capital and human resources necessary, but regulatory and structural changes also are needed before Japanese investors will view nonoil-producing countries as more hospitable investment environments.

Japan-Middle East economic links clearly have deepened and become more varied. Oil remains the main raison d'etre for commercial ties, but economic relations have a great deal of room for expansion and development. Greater Japanese investment and aid will be key determinants of the shape of future trade relations. Increasingly, though, Japanese foreign policy toward the region will have a stronger hand in shaping economic ties.

Foreign Relations

Tokyo's Middle East policy, having evolved from one of detachment to one that generally reflected trade concerns or the U.S. line, now is in the midst of another transformation. Tired of the "economic giant, political pygmy" label but cognizant of its limited leverage in the region, Tokyo has begun searching for fields where it can play a more active, or even a leadership, role. Just as the inhospitable desert has tested men for centuries, Tokyo is finding the Middle East to be a harsh testing ground for new foreign policy initiatives.

Persian Gulf War - Although hardly alone in the international community at being caught off guard by Iraq's invasion of Kuwait, Tokyo also was at a loss when the United States exercised its military option almost as quickly as it pursued other, diplomatic alternatives, including economic sanctions. While Tokyo's actions during the Persian Gulf crisis and the war's general impact on Japanese foreign policy revealed a certain amount of policy ferment (see JEI Report No. 6A, February 15, 1991), these still occurred against a background of limitations imposed by Japan's "peace constitution" (see JEI Report No. 13A, April 5, 1991). Perhaps more revealing about Japan's attitudes toward the Middle East are the actions taken after the fighting ended and the process of building a new and stable order in the gulf had begun.

- Postconflict Cleanup - Prime Minister Toshiki Kaifu's late April decision to send Maritime Self-Defense Force minesweepers to the Persian Gulf was controversial among politicians and academicians but much less so among the general population (see JEI Report No. 17B, May 3, 1991). The dispatch of MSDF vessels well beyond coastal areas was an unprecedented act in Japan's postwar history. Mr. Kaifu's argument that the clearing of mines from Persian Gulf waters was a legitimate and peaceful act of self-defense stretched the definition of that term to new lengths, setting an important precedent. Although Mr. Kaifu cited a pledge to Western allies as another reason for the mission, domestic analysts credit intense pressure from the business community, which was worried about safe passage through the gulf for shipping, as a key factor in the politically dicey decision.

Japan's contribution to cleaning up the environmental detritus of the gulf conflict provides other insights into Japan's foreign policy. Tokyo initially targeted this area as one way Japan could contribute significantly to the multinational Persian Gulf task force. While the conflict raged, however, the government found it difficult to follow up, mainly because the equipment and personnel available to fight oil spills and oil fires are under private control. No amount of badgering by Tokyo could convince these private-sector specialists to risk a trip to the gulf while bullets and missiles were flying, although the government did send some oil booms and other equipment (see JEI Report No. 5B, February 8, 1991). Once the fighting was over, cooperation was more forthcoming as Tokyo began sending teams to assess the work necessary for offsetting the massive environmental damage. Further commitments of equipment and workers followed.

Even then, however, Tokyo cannot claim a leading role in this area. Although its contribution is on par with that of France and Germany, for example, American experts in oil fires have led the effort to extinguish the hundreds of Kuwaiti oil wells set ablaze by retreating Iraqis. The Japanese contribution was and is significant but not equal to its potential in the eyes of some domestic and foreign observers.

- Gulf Reconstruction - With a big foreign aid budget, ample private-sector funds and a world-class construction and engineering industry, Japan seems ideally suited to take up the task of rebuilding war-torn gulf economies.

Institutional and political obstacles, however, likely will limit Japan's role in this area to a supporting one.

As mentioned above, Kuwait's high per capita income level disqualifies it for official development assistance under existing Japanese guidelines. Nevertheless, Tokyo is looking into extending Export-Import Bank of Japan loans and encouraging private bank lending to assist Kuwait's rebuilding. Direct participation by Japanese contractors, however, faces political hurdles arising from Tokyo's hesitant response and limited nonmilitary participation in the gulf crisis. Kuwaiti officials directing the rebuilding thanked their liberators by giving most of the initial contracts to American and European firms (see JEI Report No. 9B, March 8, 1991). As the work proceeds, however, the Kuwaitis are expected to reduce the input of such political considerations and give heavier weight to economic factors. If this is the case, Japanese firms may have an advantage on some contracts, either because they were the original builders of a plant or facility or because they can offer better technology, contract terms or service. In any case, original estimates of the cost of reconstruction are proving to be highly optimistic and Kuwaiti reconstruction may not be the predicted "mother of all projects."

Regional Arms Control - With its peace constitution credentials, Tokyo sees a natural role for Japan in restraining arms races among small countries. Tokyo's willingness to use the promise of greater foreign aid as a carrot and less aid as a stick to encourage military spending cuts by developing countries is a notable new feature of Japan's foreign policy. Unfortunately, this carrot appears unappetizing to Arab states that generally can afford sizable defense budgets; the stick is equally unimpressive given the comparatively small amounts of Japanese aid flowing to the region. In July Prime Minister Kaifu approached the problem from another angle at the London summit of leaders from the world's major industrial democracies. He proposed to establish an arms trade register. Although Great Britain is working with Japan on this approach, its effectiveness at discouraging the arms trade is uncertain.

Overall, it is clear that Tokyo is trying to find ways to be a more active participant in the Middle East's efforts to find a stable postconflict order. Unfortunately, Tokyo's foreign policy toolbox seems to contain only ineffective implements. Because of its limited stature in the region, some analysts say Tokyo's most appropriate role may be to fall in line behind the United States with its checkbook at the ready.

Israeli-Arab Conflict - Given Japan's desire to remain on friendly terms with Middle East oil suppliers and America's staunch support for Israel, it is not surprising that Tokyo often has found itself between a rock and a hard place when dealing with Israel and the issues of the occupied territories and Palestinian self-determination. While basing its policy firmly on United Nations Security Council Resolution 242 -- which recognizes Israel's right to exist, calls for Israel to withdraw from occupied lands and urges a just settlement of refugee issues -- Tokyo strongly supports "the legitimate rights of the Palestinian people in accordance with the U.N. charter" and has adopted, self-admittedly, a pro-Arab position since 1973. Japan's voting record at the United Nations showed increasing independence from the Arab line in the 1980s, however; it either abstained from or voted against anti-Israeli resolutions with growing frequency. Initiatives by Tokyo in other areas also show that a policy reevaluation is taking place.

In 1977 Tokyo began fostering direct ties to the Palestine Liberation Organization by allowing it to open a representative office in Tokyo. Since then meetings between PLO and Japanese officials have been held sporadically, usually at the unofficial level. While steadily advocating self-determination for Palestinians and protesting Israeli treatment of Palestinians in the occupied territories, Tokyo also consistently has urged the PLO to recognize Israel's legitimate right of existence. Tokyo views mutual recognition of legitimacy by Israel and the Palestinians as a prerequisite to progress.

Foreign Minister Taro Nakayama's May 30-June 1 visit to Israel was a visible sign that Japan's emphasis on Arab and Palestinian relations is changing (see JEI Report No. 22B, June 14, 1991). Admittedly, Mr. Nakayama reiterated support for better Israeli treatment of Palestinians and an end to new Jewish settlements in occupied lands, and he urged Jerusalem to be pragmatic and flexible when considering U.S. proposals for a regional peace conference. But he also commented on another long-standing bilateral issue, the Arab trade boycott.

In response to the creation of the state of Israel in 1948 Arab nations organized a boycott against companies doing business with the Jewish nation. Although enforcement of the boycott has been flexible, Japanese companies have earned a reputation for stringent adherence. Major Japanese firms, such as Mitsubishi Motors Corp. and Fuji Heavy Industries, Ltd., are among those that have kept trade with Israel from fading away, but the boycott definitely has restrained activity. During his visit Mr. Nakayama directly attacked the boycott as an undesirable impediment to trade. He said, though, that Tokyo would not implement rules to punish firms that observe the boycott, a sanction the United States, Canada and some European nations have adopted.

Even though Tokyo has not changed its public stance on the boycott -- observance remains a decision for businesses to make based on commercial factors -- government officials apparently have been signaling privately that greater trade with the Jewish state is desirable. In April three Japanese automotive makers -- Toyota Motor Corp., Nissan Motor Co., Ltd. and Mazda Motor Corp. -- announced that they would begin direct exports of vehicles to Israel later this year. Mr. Nakayama sent a clear signal in favor of more bilateral trade when he responded positively to an Israeli request that the Export-Import Bank extend letters of credit for bilateral transactions, an unprecedented action in Japan-Israel relations. (The boycott issue may evaporate if the U.S.-sponsored peace process moves forward; Saudi Arabia, Egypt, Jordan, Bahrain, the United Arab Emirates, Qatar and Oman announced in late July that they would suspend the boycott if Israel halted new settlements in occupied lands.)

All of these steps, Tokyo hopes, will give it a bigger role in the recently revitalized Bush administration plan to hold a regional peace conference to address Arab-Israeli issues and the Palestinian problem. While the exact nature of this role is still evolving, it is not likely to be a pivotal one. Tokyo has demonstrated its willingness to use increased humanitarian and economic aid to the region as a carrot to encourage movement by both Israel and the Palestinians. Beyond this, however, Tokyo's leverage is uncertain. It is telling that Middle East countries have looked exclusively to the United States as the only nation that can forge a framework for peace. Tokyo may feel that cooperation and support for the U.S. plan is the best approach at this time. Should the American scheme fail, however, Tokyo may be encouraged to offer its own peace ideas.

Iran - Iran's strategic location (occupying the north side of the Persian Gulf and extending out beyond the Strait of Hormuz), its relatively large economy and its abundant petroleum resources logically give it an important role in Japan's Middle East policy. Prior to 1979 the Shah of Iran's position as a staunch American ally also facilitated strong trade links with Japan. As seen in Table 5, Iran ranked high on Japan's list of trading partners in the region throughout the 1970s.

The 1979 Iranian revolution presented significant challenges to Tokyo. To maintain diplomatic and commercial ties to the new radical Islamic regime, Tokyo risked Washington's wrath by initially refusing to condemn the seizure of the U.S. Embassy and its staff by supporters of Ayatollah Khomeini. After it became public knowledge in Washington that Japanese firms not only were defying the U.S.-requested boycott of Iranian oil but were paying handsome prices for Iranian crude, Tokyo felt compelled to join its Western allies in applying limited economic sanctions against Iran. Once the hostage crisis was resolved, Tokyo quickly repaired ties to Iran by lifting its sanctions and restoring commercial activity, the centerpiece of which was a giant petrochemical facility at Bandar Khomeini.

Begun in 1971 while the shah ruled, the facility was a joint venture between the Iranian government and a consortium led by Mitsui & Co., Ltd. The importance both governments attached to the project became clear when the Iran-Iraq war broke out in late 1980. Tokyo urged Mitsui not to pull out of Iran-Japan Petrochemical Co. and to continue construction. (The plant was about 85 percent complete when the fighting started.) Despite sporadic bombing of the complex over the next eight years, IJPC refused to abandon the project. After a cease-fire was arranged in 1988, Mitsui decided that the plant no longer was economically viable, arguing that it was too heavily damaged and that its equipment was out-of-date. Tehran continued to insist that the work be completed. The project, which once symbolized Japanese-Iranian cooperation, became instead a source of bilateral friction.

It was not until early 1990 that a negotiated settlement was reached, allowing the Japanese consortium to withdraw from the joint venture in exchange for a Y130 billion ($963 million at Y135=$1.00) payment to the National Petrochemical Co., the Iranian partner (see JEI Report No. 18B, May 4, 1990). In late July Iran Chemical Development Co., Ltd., the Japanese consortium, received about Y76.5 billion ($566.7 million) in partial reimbursement from the government's trade insurance fund but still faces debts of about Y72 billion ($533.3 million). NPC has announced that it still plans to refurbish and complete the facility (now called Bandar Imam), perhaps with the help of individual Japanese firms.

As for efforts to resolve the Iran-Iraq war, Tokyo sought to use its diplomatic channels during the conflict to foster negotiations when both sides tired of the fighting. Although its role cannot be characterized as decisive, Tokyo certainly was in a better position than was Washington to act as a go-between -- a role it played even when Japanese tankers transiting the Persian Gulf were damaged by Iranian missiles and mines.

The taking of Americans as hostages in Lebanon in the mid-1980s again put Tokyo on the spot with Washington when the White House -- certain that Tehran was encouraging the abductions -- demanded in late 1987 that sanctions be imposed against Iran. Tokyo demurred, pointing to a lack of evidence of Tehran's complicity, including the Islamic regime's denial that it encouraged the kidnappings. This time, Tokyo deflected some U.S. ire by making sure that Japanese oil companies did not increase purchases from Iran. (Neither were contracts canceled, however.) Japan's open diplomatic lines to both Tehran and Washington, moreover, served as an important conduit for negotiations and helped ease tensions.

Japan slowly has rebuilt its commercial dealings with Iran since then, but two new issues threaten this progress. The Islamic regime inherited a large amount of American weaponry when it overthrew the shah, arms that were put to use against Iraq in their mutual war. An American investigation of sales of spare weapons parts to Iran led to the admission by Japan Aviation Electronics Industry, Ltd. this past July that it had repaired missile parts for and sold replacement aircraft parts to Iran near the end of the war with Iraq (see JEI Report No. 26B, July 12, 1991). Tokyo has pledged even tighter monitoring of trade with Iran, disappointing Tehran, which still has an American-stocked arsenal. Whether this incident will cool commercial activity remains to be seen.

Tokyo's handling of a potentially explosive incident illustrates the differences and similarities between Japanese and American attitudes on certain subjects. For example, the mid-July murder of the Japanese translator of The Satanic Verses, a book considered blasphemous by many Islamics, raised speculation immediately that there was a possible link to a 1989 death threat imposed by the late Ayatollah Khomeini (and later affirmed by Iranian rulers) against the book's author, Salman Rushdie. The Italian translator of the book had been seriously injured in an early July attack by an Iranian, prompting Japanese police authorities to seek help from foreign and international law enforcement agencies to explore a possible linkage between the two attacks.

Chief Cabinet Secretary Misoji Sakamoto called the murder unfortunate but added it was unlikely that a formal protest would be lodged with Iran. Rather than signaling deference to Tehran, however, Mr. Sakamoto explained the lack of action by characterizing the death threat as "too outrageous" to dignify with a protest. "In this age of freedom of thought and expression it is impermissible in the civilized world to issue a death sentence because one dislikes a work of literature," he argued. Such a strong statement would raise few eyebrows coming from the White House, but because it came from a top Liberal Democratic Party official it was taken as another sign of a more assertive Japanese policy.

Japan-Iran ties have survived many trials because both sides realize the links are mutually beneficial. As Tehran works to rebuild its war-ravaged economy and reassert its influence in regional politics, Japan will continue to be an important economic partner -- providing trade, investment and aid. But Tokyo also may become something of a mentor, helping Iran to return to the mainstream of international politics as part of Japan's long-standing goal of promoting stability in the region.

Other Issues - A recent international banking scandal could influence Japan's relations with the region. Offices of the Bank of Credit and Commerce International S.A., backed by the ruler of Abu Dhabi and linked to important figures in other Middle Eastern countries, were seized in early July by regulators in Great Britain, Luxembourg and the Cayman Islands after investigations and audits revealed major irregularities in the bank's worldwide operations. BCCI's Tokyo branch office voluntarily closed its doors days later at the request of the Ministry of Finance but then moved nearly all its deposits -- Y53.7 billion ($397.8 million) worth as of March 31, 1991 -- out of Japan. MOF found that it had few legal options to prevent the transfer or control the activities of the foreign-based bank; it only lamely could ask a Tokyo court to freeze and then liquidate the branch's assets, reported to be Y83 billion ($614.8 million) as of last March. Unlike BCCI's operations in other countries, however, the amounts involved in Japan are relatively small. Ishikawajima-Harima Heavy Industries Co., Ltd., the largest single depositor with the Tokyo BCCI branch (Y13.7 billion or $101.5 million), is leading a depositor group in court proceedings to recover whatever assets remain in Japan.

While the financial impact may be insignificant, the political fallout may not be. The case is the first time a foreign bank has been liquidated in Japan and reveals a glaring hole in MOF's oversight powers. The ministry now is considering forcing foreign banks to join Japan's deposit insurance program and probably will draft legislation giving it the power to act independently and rapidly in situations similar to that created by BCCI. The affair has embarrassed both the powerful Finance Ministry and Sheikh Zayed bin Sultan al-Nahayan, the ruler of Abu Dhabi and BCCI's largest shareholder. Sheikh Zayed currently hopes to block international efforts to liquidate the bank and is offering to reorganize and recapitalize the institution. Because BCCI has a significant retail banking presence in many developing countries, depositors who can least afford it would suffer the most if BCCI were liquidated. Tokyo has yet to respond to the sheikh's reorganization plan but could turn embarrassment into benefit if it finds the plan worth supporting.

Rethinking Fundamentals

A strong current running through the Japanese debate over Middle East policy is a reevaluation of the region's importance to Japan. In terms of the monetary value of bilateral trade, it is clear that the Middle East is important but ranks well below North America or Asia as a destination for exports or as a source of imports. The region's role in Japan's energy picture remains significant, however, and likely will remain so well into the next century.

Despite this, Tokyo's domestic reaction to the embargo on trade with Iraq and Iraqi-occupied Kuwait almost was nonchalant. Armed with strategic oil reserves equivalent to many months of imports from the two countries as well as prearranged international cooperation to regulate energy supplies among oil-consuming nations and pledges to increase output by other oil-producing nations, Japanese government and business spokespersons reassured the public that any economic fallout from the Persian Gulf crisis would be minimal. Contrast this response to the public panics that swept the nation during the twin oil shocks of the 1970s and the efficacy of Japanese energy planning is obvious. Japan weathered the latest crisis so successfully that some wondered if Middle East oil truly was vital.

Because crude oil is a relatively fungible commodity (oil from one well generally can substitute for that from any other), some analysts have argued that the Middle East's importance to Japan's energy supply is overblown. As long as Middle East oil is available as a part of global supplies, it is unimportant where or from whom Japan buys its oil, runs the suggestion. This thinking led many Japanese at the time of Iraq's invasion of Kuwait to downplay the action's economic importance since oil from Kuwait's wells again would be sold on world markets once Iraqi leader Saddam Hussein digested his conquest. While this logic was correct from a purely business standpoint, it clashed head-on with Japan's new image as a global power willing to stand for principle and not just self-interest.

Equally important, the argument is based on the premise that Middle Eastern oil always will be available. The 1973-74 OPEC oil boycott and the mining of the Persian Gulf during the Iran-Iraq war show that this is not a defensible assumption. If the flow of oil from the region were shut off for any reason, the Middle East's importance to Japan and the rest of the world quickly would become apparent. While Tokyo will continue to pursue a greater role in the region's political jungle, oil-based trade will remain the raison d'etre of Japan-Middle East ties.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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AMERICAN AND JAPANESE ATTITUDES ON BILATERAL RELATIONS: A CRISIS IN THE MAKING?

Summary

Although Japan contributed about $13 billion to support the allied coalition that fought in the Persian Gulf War, the nature and the timing of Tokyo's response to the crisis angered many in the United States. Conversely, the Bush administration's willingness to go to war and its call for support from Japan raised questions about Japan's foreign policy goals. Public grumbling on both sides of the Pacific resulted in renewed attention to the alliance's health.

While the gulf crisis undoubtedly had an impact on the way Japanese and Americans view each other, an erosion of mutual goodwill was becoming apparent at least five years ago. Some analysts have attributed the change to the strains resulting from economic competition between the two countries. Others have suggested that changing views of the economic, political and military aspects of U.S.-Japan relations actually reflect the tensions of a relationship in transition within a global system that also is undergoing transformation.

Public opinion data, however, do not necessarily reflect the views of the decisionmaking elite, which may be influenced by broader considerations than the current developments that often sway opinion polls. The elite and the media, in turn, have played, and will continue to play, important roles in shaping public attitudes. Some analysts maintain that the media, in particular, have affected a negative shift in public opinion through the sometimes sensational depiction of issues in bilateral relations.

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"Bashing" from Both Sides on the Rise

The May 6 cover story of Fortune magazine, entitled "The Big Split," portrayed a U.S.-Japan alliance in trouble. "Bashing" on both sides of the Pacific is on the rise, the article suggested, creating a very problematic outlook for bilateral relations in the near future.[1]

For the past several years some Americans have chosen to vent their frustrations with the still-staggering bilateral trade imbalance and related competitiveness problems by laying the blame on Japanese business practices. Congress, in particular, has been the source of much anti-Japan rhetoric -- often called "Japan-bashing." A spate of books, articles, studies and other projects have sought further to make the case that Japan operates according to a different set of rules and, if allowed to go unchecked, poses an economic threat to the United States.[2]

As the media cover these analyses, the rhetoric over U.S.-Japanese relations heats up in what many see as a topic of interest primarily for Washington insiders, who include policymakers. A 1990 book by Pat Choate, formerly of TRW Inc., on the influence of foreign business and government interests through lobbyists in the United States was said, for example, to have been read from back to front as Washington readers scanned first the index, then the section(s) that cited them. Regardless of the impact of such books outside Washington, however, they do become subjects of congressional hearings and often legislation. A recent study on Japan for the Central Intelligence Agency, for example, was grist for a July hearing by the House Foreign Affairs Subcommittee on Asian and Pacific Affairs (see JEI Report No. 28B, July 26, 1991).

Discussions on television and radio talks shows, news reports in the print media and hearings on Capitol Hill raise the awareness of the U.S.-Japan relationship throughout the country. The implications of economic competition may generate the most concern at the grass roots. But policymakers have a broader field of worry, since frustrations in the economic area spill over into bilateral defense relations.

For over 20 years American legislators have questioned the extent to which U.S. military protection has enabled Japan's phenomenal economic progress to occur. As trade irritations between the United States and Japan began to intensify in the 1980s, congressional criticism of Japan's defense role grew harsher, and legislators became more aggressive in trying to rectify perceived inequities. Tokyo was urged to use more of its wealth for defense so that the United States, in turn, could shift more defense monies toward regaining its

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[1] Carla Rapoport, "The Big Split," Fortune, May 6, 1991, p. 44.

[2] Examples include: Pat Choate, Agents of Influence (New York, New York: Alfred A. Knopf, 1990); Andrew J. Dougherty, Japan 2000, a report prepared for the Central Intelligence Agency under the auspices of the Rochester Institute of Technology, February 1991; and Karel Van Wolferen, The Enigma of Japanese Power (New York, New York: Alfred A. Knopf, 1989).

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industrial competitiveness (see JEI Report No. 38A, October 6, 1989). Thus, when Iraq invaded Kuwait a year ago Japan's apparent unwillingness to come quickly to the aid of its allies -- through provision of money and/or personnel -- further appeared to bolster the view that Tokyo cares only for its economic self-interest (see JEI Report No. 6A, February 15, 1991).

Until recently Japanese policymakers for the most part quietly endured criticism like this. Tokyo typically responded in a very measured (some would say minimal) way to U.S. demands that it open its markets and create greater transparency in its business practices. In the defense area the Japanese government qualitatively upgraded its military capabilities according to mutually agreed upon self-defense goals and assumed ever-greater levels of host-nation support (see JEI Report No. 35A, September 14, 1990).

The Persian Gulf crisis may have shattered Tokyo's reserve or brought to the fore long-held resentments about being a U.S. whipping boy. The Japanese now are "talking back," according to Fortune writer Carla Rapoport, who cited their irritation with being blamed for U.S. economic failings. Among other matters many Japanese were offended that Tokyo's $13 billion or so in gulf-related assistance did not appear to count for much as far as the United States was concerned. They are "bristling with arrogance and self-confidence," Ms. Rapoport wrote, referring, among various findings, to a study of U.S.-Japan relations commissioned by the Ministry of Foreign Affairs. That study said that Japan's rise as an economic superpower had reawakened Japanese nationalism in the form of anti-Americanism: "The American people and policymakers seem to refuse to acknowledge the country's decline and need for improvement . . . [and] there is a growing feeling that further [trade] concessions to the U.S. are unnecessary."[3]

There was concern in some official quarters in Japan that the August 6 commemoration of the U.S. bombing of Hiroshima to help end World War II would prompt displays of anti-American rhetoric. While this did not occur, events such as a one-day international antinuclear conference were a reminder to the global audience of the enduring nature of Japanese pacifism -- an aspect of contemporary Japan that some Japanese policymakers feel the United States and other Western allies do not accredit fairly in analyzing Tokyo's behavior during the gulf crisis.

Ms. Rapoport concluded that "the ground ahead of the U.S. and Japan on the trade and defense fronts will be the rockiest since the [Persian Gulf] war." Although the Hiroshima anniversary came and went without apparently fueling U.S. "bashing" in Japan, some observers of bilateral relations are worried that the 50th anniversary of Japan's December 7, 1941 attack on Pearl Harbor may unleash strong U.S. sentiments against Japan. In this regard, the results of a May poll by Nihon Keizai Shimbun are revealing. When American respondents were asked whether they recall Pearl Harbor when thinking of Japan, 49.7 percent said they did; 48.5 percent said no. When Japanese respondents were asked whether they recall Pearl Harbor when thinking of the United States, 55.2 percent said yes; 40.3 percent said no.

One way to interpret these results is that World War II still shapes perceptions of each other. For some people, war memories still aggravate the adversarial nature of current economic relations. It is no wonder that President Bush, meeting with Prime Minister Toshiki Kaifu in Kennebunkport, Maine in mid-July, expressed his interest in finding out firsthand about Japanese attitudes toward the United States when he visits Japan in November.

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[3] Rapoport, op. cit., p. 39.

The Value of Public Opinion Data

To get a sense of just how rocky the road may be in this post-gulf war period in U.S.-Japan relations, Mr. Bush's staff -- as well as anyone else with any sort of business or political interest in bilateral affairs -- no doubt will keep at least one eye trained on a variety of recent (and ongoing) surveys of public opinion. The decisionmaking elites of industrial democracies, comprised of government and business leaders, at least in theory develop policies and action plans that reflect the popular will. Thus, when a member of Congress lambastes Japan's apparent unwillingness to do little more than "write checks" to support the allies in expelling Saddam Hussein's army from Kuwait or introduces legislation that seeks to redress Tokyo's allegedly unfair trading practices, he or she presumably is responding to constituent sentiments.

It is important to bear in mind, however, that decisionmakers' views may differ from those held by the general public. This divergence may serve to either moderate or sharpen certain policies. (Unemployed auto workers, for example, might support import restrictions on Japanese cars and other products, while the actual policy developed by the American decisionmaking elite is less protectionist.) As will be discussed later, business and political leaders as well as the media also can shape popular opinions to support a favored course of action. The public's views, in short, are susceptible to manipulation.

Public opinion surveys, thus, are not a definitive indicator of where relations are headed. Yet, neither can they be ignored. Policymakers and observers of U.S.-Japan relations typically regard polling data as a useful guidepost or a barometer that indicates areas of concern affecting the conduct of bilateral affairs.

Impact of the Gulf War on Public Opinions

Prior to Saddam Hussein's sending his army into Kuwait, one of the more striking aspects of Washington's relations with Tokyo had been the degree to which relations were perceived as friendly despite the many areas of tension. Interestingly, survey analysts have noted that even with the amount of attention given to "Japan-bashing" in the United States, overall sentiment here toward Japan has ranked consistently warmer than Japanese attitudes toward the United States (see JEI Report No. 9A, March 2, 1990). Polls taken prior to August 1990 reflected the most positive opinions among Americans toward Japan since the mid-1980s. The less than sanguine assessment of bilateral relations expressed by the Japanese, in contrast, tended to reflect the cumulative impact of anti-Japan diatribes in Congress and contentious trade negotiations, among other factors.[4]

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[4] William Watts, Uneasy Eyes Across the Pacific (Washington, D.C.: Commission on U.S.-Japan Relations for the Twenty-First Century, September 1990), p. 3.

In one of a series of polls by the New York Times/CBS News[5] people were asked:

> How would you describe relations between Japan and the United States today? Would you describe them as very friendly, somewhat friendly, somewhat unfriendly, or very unfriendly?

	1985	1986	1987	1988	1989	1990
United States						
Very friendly	23%	22%	13%	14%	17%	18%
Somewhat friendly	65	63	59	59	62	66
Somewhat unfriendly	6	7	17	14	10	10
Very unfriendly	1	1	2	3	2	2
Don't know	5	7	9	10	9	4
Japan						
Very friendly	5%	4%	1%	2%	11%	3%
Somewhat friendly	68	62	42	52	57	60
Somewhat unfriendly	20	26	48	40	25	33
Very unfriendly	1	3	7	3	4	3
Don't know	6	5	2	3	3	1

Polling done after the war presents mixed views, making it hard to determine the extent of the alleged deepening rift in bilateral relations. Polls conducted by Jiji Press over a 30-year period, for example, showed that the United States by far was the "most liked" of the 10 countries Japanese respondents were asked to rank in order of preference. The following responses show only slight variations for the United States as the country "most liked" over the past six years, even with the intrusion of the Persian Gulf War:[6]

> Of the following (10) countries, please choose three countries you like. (For comparison purposes, rankings for the United States, the Soviet Union and China are featured.)

	1985	1986	1987	1988	1989	1990	1991*
United States	43%	42%	38%	41%	43%	44%	43%
China	23	21	21	20	11	9	11
Soviet Union	1	1	1	1	1	2	2

*Through June 1991.

A May 1991 survey by Nihon Keizai Shimbun, however, gave slightly different results. Japanese respondents ranked Canada (78.2 percent), the United

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[5] New York Times/CBS News/Tokyo Broadcasting System poll, June 5-8, 1990 among Americans; May 31-June 6, 1990 among Japanese.

[6] Twelve-month averages of monthly polls by Jiji Press from January 1985 through June 1991.

Kingdom (73.7 percent) and France (73.5 percent) higher than the United States (71.1 percent) when asked to indicate what countries they liked. American respondents ranked Japan seventh (66.5 percent) behind Canada (94.1 percent), the United Kingdom (86.1 percent), Italy (84.2 percent), France (81.5 percent), Germany (81.5 percent) and Mexico (75.2 percent).

Responses to another question in Nikkei's May poll suggest that the Persian Gulf conflict may have begun to deplete the reservoir of goodwill each nation holds for the other. This appears particularly so from the U.S. side.

What is your evaluation of the role played by the United States (Japan)?

United States	
Highly appreciate	4.7%
Rather appreciate	26.9
Don't appreciate very much	33.3
Don't appreciate at all	29.0
Can't say	6.2

Japan	
Highly appreciate	20.0%
Rather appreciate	41.2
Don't appreciate very much	29.8
Don't appreciate at all	5.7
Can't say	3.3

Perhaps one of the more telling indicators of how the gulf crisis affected mutual levels of trust was Nikkei's question concerning reliability. Prior to the Middle East conflict Americans were divided fairly evenly in their view of Japan as a reliable/unreliable ally (44.9 percent/44.7 percent). Japanese were more convinced of U.S. dependability; 57.5 percent felt the United States was a "reliable ally," 26.6 percent, unreliable. By May 1991 many more Americans felt that Japan was much less reliable than before the gulf war; Japanese respondents, too, appeared less convinced of the United States as a stalwart friend. The following question was posed:

Is the U.S. (Japan) reliable now, or unreliable, when compared to before the gulf war?

United States	
More reliable than before	21.9%
No change from before	21.4
Less reliable than before	43.7
Can't say	13.0

Japan	
More reliable than before	15.8%
No change from before	42.3
Less reliable than before	34.7
Can't say	7.2

While the above presents a rather bleak outlook for alliance relations, it still may be too soon to know whether the level of trust between the two countries has been irreparably shaken. When Nikkei asked American and Japanese respondents about the outlook for bilateral relations, 62.5 percent of the Japanese thought that the two countries' relations would remain unchanged; 23.2 percent thought relations would worsen; 10 percent were optimistic about the future. Interestingly, American responses appeared more positive: 34.2 percent thought relations would improve; 39.7 percent felt relations would remain unchanged; 20.2 percent believed that relations would take a turn for the worse.

Judgments concerning reliability, in particular, may shift -- positively or negatively -- depending on bilateral and global developments. Tokyo's recent willingness to extend an additional Y70 billion (which works out to $518.5 million at Y135=$1.00 or $500 million at the Y140=$1.00 rate used by the government) to support peacekeeping activities in the Persian Gulf and Kurdish refugee relief, for example, evoked supportive comments from administration witnesses testifying before an early August House Ways and Means Committee hearing. These statements might begin to change perceptions at the American grass roots of Japan's apparent reluctance to support not only its longtime ally but to extend itself internationally. They also might begin to assuage Japanese who feel that the United States, in one Japanese official's words, "did not appreciate [Japan's] good-faith effort to do what it could in the face of the first major military challenge since World War II."[7]

The fact that more money was disbursed after Washington complained about a shortfall in Tokyo's January pledge of $9 billion to support the allied war effort (see JEI Report No. 20B, May 24, 1991) might not promote a favorable impression on decisionmakers from either side of the Pacific. Had Tokyo been unwilling to make up the shortfall, another round of mutual recriminations might have followed and further fueled negative feelings. The Japanese government's action represented a symbol of Japan's commitment; often symbols play a crucial role in shaping public views. If mutual trust is to be restored, both sides may have to undertake more initiatives that symbolize a desire for more cooperative relations.

Japan's Military Role and Bilateral Defense Relations

The crisis caused by Iraq's invasion of Kuwait and the issue of how Tokyo should support the coalition forces that were fighting in the Middle East forced Japan to grapple with one of the core tenets of its postwar foreign policy -- no military engagement abroad. Although Japan maintains armed forces for self-defense purposes, for 46 years its "peace constitution" has been interpreted as banning the overseas dispatch of military personnel. Japan's protracted and minimal (in allies' views) pledges of nonmilitary monetary assistance during the Persian Gulf War irked many coalition members. Moreover, Tokyo's unwillingess to dispatch support personnel to the Middle East led to charges that Japan was "hiding behind its constitution" rather than putting itself at risk with the rest of its allies.

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[7] Taizo Watanabe, "Frictions in the United States-Japan Relationship: Past, Present and Future," speech before conference on Japanese and American Media: Coverage of Friction Between the Two Nations, April 29, 1991, Honolulu, Hawaii.

The difficulties the Japanese government encountered in responding to American and allied requests for both money and "presence" illustrated the deep-seated nature of Japanese pacifistic sentiments as well as Tokyo's lack of a coherent vision of its global role (see JEI Report No. 6A, February 15, 1991). In an effort to respond to allied requests for a Japanese "presence" in the Middle East after Kuwait was occupied, Prime Minister Kaifu last fall proposed legislation that would have authorized Tokyo to establish a 1,000-member "peace cooperation team" composed of both civilians and Self-Defense Forces personnel. In November 1990 he was forced to withdraw the bill from the Diet due to the strong opposition it encountered at home as well as in Southeast Asia. A Nikkei poll conducted at that time revealed that 48.5 percent of those questioned opposed the dispatch of SDF members under any conditions, while 28.4 percent believed "unarmed troops" could be sent abroad. Only 23.1 percent favored Mr. Kaifu's proposal.

As the Middle East conflict escalated and allied pressures intensified for Japan to assume the responsibilities attendant on a global economic power, the polls also shifted, perhaps indicating an evolution of Japanese views on their country's role in the world. When the air war broke out in the Persian Gulf in mid-January, Tokyo came forward with support of $9 billion, which was on top of previous pledges totaling $4 billion. Mr. Kaifu's government also announced that it would take the unprecedented step of dispatching military aircraft to help evacuate refugees from the war-torn region.

A subsequent Kyodo News Service poll indicated that, unlike their reaction to the peace team plan two months earlier, Japanese at the grass roots were more supportive of involvement along these lines; 70 percent favored the $9 billion contribution and 56 percent supported the government's proposed use of SDF equipment and personnel for refugee evacuation purposes.[8] A NHK (Japan Broadcasting Corp.) survey in late February also found that 71 percent of the respondents favored the dispatch of noncombatant personnel as well as financial assistance as appropriate ways in which Japan could respond to United Nations' requests for gulf war-related support.[9]

Two months later the public mood had changed so much that Tokyo was able to launch with minimal fuss its first overseas military mission since World War II; four Maritime Self-Defense Force minesweepers and two support vessels set sail in late April to assist with postwar cleanup of the mine-ridden Persian Gulf (see JEI Report No. 17B, May 3, 1991). Granted, this action was taken after the hostilities had ended, but it was significant, nevertheless, when compared to Tokyo's near paralysis the previous fall in the face of public outcry. According to Foreign Ministry sources, one poll showed that 60 percent of the Japanese questioned either actively favored the dispatch of the minesweepers to assist with mop-up operations or agreed that Japan had no choice but to send them.[10]

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[8] Larry A. Niksch and Robert G. Sutter, "Japan's Response to the Persian Gulf Crisis: Implications for U.S.-Japan Relations," CRS Report for Congress, May 23, 1991, p. 20.

[9] NHK conducted a telephone survey February 23, 1991 of 1,800 Japanese men and women, aged 20 years and over.

[10] Watanabe, op. cit.

Mr. Kaifu plans to consider a new proposal during the current extraordinary Diet session that would allow for a SDF role in United Nations-sponsored peacekeeping missions. Unlike last November, the proposal now enjoys the full support of the ruling Liberal Democratic Party and two of the opposition parties. This reversal of opinion may represent the public's growing awareness that Japan's postwar foreign policy requires redefinition.

There is no recent polling data covering Americans' views specifically on Japan's defense role. Surveys from before the Middle East conflict, however, suggest that both publics believe each side generally benefits from the bilateral security treaty. Consider the following Louis Harris/Asahi Shimbun poll done in April-May 1990:

> All in all, do you think the United States (Japan) benefits from the bilateral security treaty?

United States	
Benefits	54%
Does not benefit	36
Don't know	10
Japan	
Benefits	48%
Does not benefit	23
Don't know	29

As early as November 1989, however, there were indications that the Japanese public (52 percent in a Harris survey) favored more independence from the United States in both defense and foreign policy. Two surveys done in April-May 1990 by Harris/Asahi and the Wall Street Journal/Nikkei confirmed this trend and showed that Americans, too, appeared to favor a more autonomous ally.[11]

> Do you think Japan should continue to depend on the U.S. military for conventional and nuclear protection or should Japan build its own independent military system?

United States	
Continue dependence	22%
Build own independent system	71
Neither	3
Don't know	4
Japan	
Continue dependence	31%
Build own independent system	40
Neither	18
Don't know	11

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[11] Watts, op. cit., p. 4.

Do you think Japan should or should not stake out a foreign policy that is independent of the United States?

United States

Should	50%
Should not	36
Don't know	14

Japan

Should	44%
Should not	17
Don't know	39

In one sense these survey results do not seem to explain why Tokyo appeared to flounder in responding to the Middle East crisis. Perhaps many Japanese, like at least a plurality of people in other industrialized democracies, feel it is imperative that their country provide for and maintain its own self-defense capability. But building an independent system and dispatching personnel to a foreign conflict area are two separate issues. The former may not be viewed as being in conflict with Japan's constitutional constraints; the latter apparently was. Similarly, while many Japanese may support the idea of a more autonomous foreign policy, the protracted and contentious process that characterized Tokyo's decisionmaking on the gulf crisis would appear to indicate that little work has gone into conceptualizing a new diplomatic mission among decisionmakers, let alone at the grass roots.

As will be discussed later, the gap between public views and actual policy as reflected in these polls may be indicative of the influence of decisionmaking elites. The fact that Tokyo has not realized much progress in developing an independent military system is because defense policymakers in Japan as well as the United States oppose that trend. In the same vein Tokyo's efforts to pursue a more independent diplomacy have not always been welcomed in some Washington quarters; Japan's decision at the July 1990 summit of the seven major industrial democracies to resume economic assistance to China is a case is point (see JEI Report No. 27B, July 13, 1990). While citizens in both countries may favor a more autonomous Japan, statements by officials of each country indicate that the two governments would prefer a more gradual approach for rethinking Japan's postwar foreign policy and reinterpreting its constitutional limits.

Economic Relations: Japan as the "Critical Threat" to U.S. Interests

Japan's apparent unwillingness to contribute "sweat," much less blood or lives, to help its allies in the Persian Gulf crisis generated negative feelings in the United States. Fanning those sentiments was the manner in which Tokyo pledged monetary support. Americans saw the financial backing as something that was wholly within Tokyo's constitutional parameters and economic wherewithal, even if they did not entirely understand the limitations on personnel support. Offsetting the significant sums pledged was the impression that pressure from Washington was necessary to get financial support from Japan. This left a strong view of a Japan that is stingy with its vast economic wealth, wealth associated with an enormous trade surplus with the United States and most other developed countries. Many Americans and people in other allied countries were offended that Tokyo appeared unwilling to draw from its well to help resolve an international crisis -- particularly one in which Japan was seen as having a substantial stake because of its 70 percent dependency on Middle East oil.

A Gallup, Inc. poll of the public and the decisionmaking elites during the January-March 1991 period (after Tokyo came forward with its additional $9 billion pledge) found that 70 percent of the decisionmakers (a 20 percentage point increase over last year) and 49 percent of the public thought that Japan does not play an international role commensurate with its economic strength.

Japan's economic strength, much more than the political exercise of its influence, tended to dominate public opinion polls prior to the gulf crisis. The tensions generated by a chronic bilateral trade imbalance and Japan's growing economic power typically have been the major focus of attention. The Chicago Council on Foreign Relations' 1991 survey of American public opinion on U.S. foreign policy revealed, for example, that both the public (60 percent) and the decisionmaking elites (63 percent) regarded the economic power of Japan as a critical threat to the United States in the next 10 years. This assessment, remarkable for the nearly identical perceptions among the public and the decisionmaking elites, far surpassed the perceived threat posed by Soviet military power (33 percent of the public and 20 percent of the decisionmakers).

Even with last year's conclusion of the contentious Structural Impediments Initiative talks (see JEI Report No. 26B, July 6, 1990) and the resolution of fractious disputes concerning trade in certain product areas, the Chicago group's survey found that 71 percent of the public and 78 percent of the decisionmakers polled believed that Japan practices unfair trade with the United States. A July 1990 poll of American, Japanese and European business executives done by Louis Harris/NHK/Business Week confirmed these sentiments and, interestingly, revealed that those who were polled in Japan concur that it is incumbent on their government to open markets there.[12]

As an increasingly powerful economic force, Japan should take what steps internationally to foster global economic prosperity?

	United States	Europe	Japan
Open its domestic markets	63%	65%	76%
Work toward promoting free trade	58	43	71
Open its capital markets	41	39	29
Increase aid to developing countries	34	39	58
Transfer its technology abroad	27	29	54

The business community's view that Japan does not trade fairly appears to have intensified in the wake of the gulf war. A report released in early August by the Japan Economic Foundation, an organization affiliated with the Ministry of International Trade and Industry, included the results of an April-May

[12] Watts, op. cit., p. 13.

1991 poll of about 500 American politicians, business leaders, academics and trade union officials. The report said that 85.3 percent of the respondents felt that Japan's trading practices are unfair; 65.7 percent called on Japan to open its markets. In addition, 24.5 percent of the people questioned called for retaliatory action to pressure Japan to open its markets, a 6.2 percentage point increase over the foundation's 1990 findings. Only 29.2 percent of the decisionmaking elites surveyed urged U.S. companies to boost competitiveness, perhaps a reflection of American policymakers' apparent inability or unwillingness to enact laws with sometimes painful consequences or to implement policies that would improve U.S. productivity.

When it comes to protecting domestic industries, however, a June 1990 poll by the New York Times/CBS News/Tokyo Broadcasting System revealed that Americans may have a double standard; they appear to favor protection of certain U.S. industries but are critical of similar behavior by Japan.[13]

> Which of the following statements comes closer to your opinion -- (1) trade restrictions are necessary to protect domestic industries; or (2) free trade must be allowed, even if domestic industries are hurt by foreign competition?

	May 1988	June 1989	June 1990
United States			
Restrictions necessary	51%	54%	56%
Allow free trade	39	36	34
Don't know	10	10	10
Japan			
Restrictions necessary	57%	62%	59%
Allow free trade	40	35	34
Don't know	4	3	7

Japanese direct investment in the United States, which, until moderating last year, had grown at a rate of 45 percent-plus over the 1987-89 period, also has sparked angry reactions in this country. There is a concern that the control that Japanese investors have over U.S. fixed and financial assets has enabled Japanese companies to gain too much influence in this country. Among the more controversial purchases have been Sony Corp.'s buyout of Columbia Pictures Entertainment Inc., Mitsubishi Estate Co., Ltd.'s purchase of a stake in a group that owns part of Rockefeller Center and Matsushita Electric Industrial Co., Ltd.'s purchase of MCA Inc. Cries that America is being "bought" by the Japanese, in turn, have prompted American lawmakers to push legislation that would limit foreign investment or prohibit it in certain areas (see JEI Report No. 34A, August 31, 1990).

While post-gulf war polling data on American grass roots attitudes are not readily available, previous surveys indicate a divergence of views between the public and the decisionmaking elites. A poll taken by the Washington, D.C.-based consulting firm of Smick-Medley & Associates in 1988, for example, found that while 78 percent of the ordinary citizens surveyed felt that foreign investment should be limited, only 13 percent of the decisionmakers questioned shared that view. Moreover, in contrast to the 40 percent of the mass sample who would support legislation to prohibit further foreign investment in U.S. businesses and real estate, only 1 percent of the public officials polled favored such a measure.

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[13] Watts, op. cit., p. 14.

A May 1990 poll by the Wall Street Journal/Nikkei found that the average American's concerns about the level of Japanese investment in the United States had not lessened: 69 percent said the amount of Japanese investment in this country was "too much;" 23 percent said the amount was "about right."[14] The Gallup organization's January-March 1991 survey of decisionmaking elites revealed that even Japan's handling of the gulf crisis had not measurably changed policymakers' opinion that Japanese direct investment should not be curbed; 70 percent stated that an increase in Japanese direct investment in this country would benefit the United States.

Although concerned about the nature and the extent of Japanese ownership of U.S. assets -- and angry and disappointed that Japan did not appear more willing to support the allies during the Middle East crisis -- the American public continues its love affair with Japanese products. A post-gulf war USA Today poll revealed that 42 percent of the Americans surveyed felt that the gulf war would have no effect on their purchase of Japanese goods; 31 percent said they would be less likely to buy Japanese products; 22 percent indicated they always buy American-made products.

The May 1991 Nikkei poll also indicated that Japan's response to the Middle East crisis had not affected Americans' image of Japanese products: 42 percent said they thought Japanese products were "rather good;" 31.5 percent found them "very good;" only 23.7 percent said they thought Japanese products were "ordinary" or "not very good." The same poll revealed that 89.5 percent of the American respondents currently were using Japanese products or had used them before.

Japanese responses to the Nikkei survey may reveal the attitudinal barriers U.S. manufacturers of consumer products face in trying to crack the Japanese market. In terms of image 71.7 percent of Japanese respondents said that American products were "ordinary," "not very good" or "not good;" only 18.2 percent said they were "very good" or "rather good." Forty-six percent of the Japanese polled indicated that they had not used American products before; 38.4 percent said they were using them now or had used them before.

Media Influence: Reflecting Opinion or Shaping It?

As mentioned above, public opinion is not formed in a vacuum. Decisionmaking elites, such as heads of government or influential lawmakers, can shape the popular view to support their policies. The media also can affect how the people of each country view the other. For example, in 1987 after it had been revealed that Toshiba Machine Co., Ltd. sold sophisticated machine tools to the Soviet Union in violation of Japanese export control laws, a junior member of Congress from Maryland, Helen Bentley (R), and three of her colleagues hammered a Toshiba radio on the steps of the Capitol. This episode, which received some coverage in the U.S. media -- and was derided "inside the beltway" as overly dramatic -- was broadcast repeatedly in Japan. Similarly, Cable News Network's coverage of the Persian Gulf War included a clip of Japanese politicians anxiously debating in the Diet how Japan should respond to this crisis while outside Tokyo shops sold Saddam Hussein souvenirs.

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[14] Watts, op. cit., p. 14.

Both of these treatments evoke strong emotions in the viewing audience and create powerful images. Is the media guilty of fomenting Japan- and America-bashing? This was the subject that Japanese and American correspondents sought to tackle during a spring conference in Hawaii sponsored by the Mansfield Center for Pacific Affairs and the Dentsu Institute for Human Studies. According to a survey of the 52 American, Japanese and other Western journalists who attended the conference, the majority felt that adversarial-type reporting and commentary by the news media in both countries will continue to strain already uneasy bilateral relations.[15]

Robert Hewett of the East-West Center, who coordinated the survey, pointed out that both American and Japanese correspondents, in significant numbers, placed the main responsibility on editors back home for the "emotional war of words." Some of the journalists were critical of their editors for "overdramatizing and overdrawing" what is really happening. One Japanese writer maintained that most Japanese editors want stories on controversy or sensational events; they want to focus on "what's wrong with America" and are not interested in "what works in America," he said. The journalists agreed, however, that while the nature of news coverage has heightened tensions in bilateral relations, the stories reflect, but do not cause, bitter disputes.[16]

These views are shared by some members of the Washington policymaking community, who contend that, on U.S.-Japan issues in particular, the media easily can be manipulated into giving prominence to a point of view that does not necessarily reflect mainstream thinking. Rep. Bentley and Rep. Byron Dorgan (D, N.D.) have been quoted by the media more often than is typical for a junior legislator, not because they are experts on Japan or articulate widely held views but because they are such harsh critics. Insofar as coverage of them is disproportionate, this sends an inaccurate signal to the Japanese public and may skew some Americans' views of Japanese behavior.

While many journalists and policymakers in both countries appear aware of the flaws in coverage, there was not a clear consensus at the Hawaii conference on whether public opinion is influenced by skewed reporting or editorial decisions. Gary Langer, an ABC News polling analyst, argued that coverage of Japan has not changed American opinion, citing a 65 percent approval rating of Japan in March 1991 as compared with 62 percent last year. "If you asked people if they thought less of Japan because of its response in the gulf, they would say yes, but just because people say they're annoyed at someone doesn't mean they don't like them anymore," he reportedly stated. He argued that it is not the coverage, but the events themselves, that change public opinion.[17] Cokie Roberts, an ABC News commentator, disagreed on the importance of media-conjured imagery and symbolism. During the Middle East war "one picture of Japanese medics saving one American soldier or one Kurdish baby would have made an incredible impact, more than any number of billions of dollars," she reportedly emphasized.[18] In terms of improving the quality of coverage, many of the conference participants said that increased study of language, history and culture plus more reporting on aspects of the latter two areas, which often shape current bilateral misunderstandings, would be helpful.

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[15] "Correspondents Give Their Views on Japan-U.S. News Coverage," a survey for discussion at conference on Japanese and American Media: Coverage of Friction Between the Two Nations, April 28-May 1, 1991, Honolulu, Hawaii.

[16] Ibid.

Outlook for Bilateral Relations

Do the opinion polls indicate that U.S.-Japan relations are headed for a crisis? While Japan's response to the Persian Gulf War has interjected additional strains into already tense relations, a permanent rift is unlikely. Decisionmaking elites -- at least on the U.S. side -- no doubt will work to ensure that the alliance hangs together, despite possible calls from the grass roots for retaliatory economic measures or a sharp change in bilateral defense relations. The United States and Japan are the world's two largest economies, whose interactions have ripple effects throughout the global economic system. In addition, they share a democratic political tradition and defense relationship that both sides recognize as important for ensuring stability in the Asian Pacific region. Using the Chicago Council on Foreign Relations' 1991 survey as a barometer of this commitment, 95 percent of the American decisionmaking elites polled believed that the United States has a "vital interest" in Japan; 79 percent of the U.S. public shared this assessment.

Some analysts have proposed that the increased negativity reflected in recent polls actually is indicative of the tensions and the frustrations inherent in a relationship that is undergoing transition as the Cold War order changes. It behooves both countries, this argument goes, to manage this transition in a manner that continues to provide stability in the Asian arena as well as economic prosperity to the world (see JEI Report No. 9A, March 2, 1990).

Ronald Morse of the Economic Strategy Institute concurs that the apparent resentment actually masks stronger undercurrents of bilateral cooperation. "The perception [in the United States] of Japan as a menace resulted largely from the distorted economic policy environment of the 1980s," he maintains. "[During the post-gulf war period] Japan's relations with the United States will become more open (transparent) and less politically charged, and the results of microeconomic convergence and structural adjustments from the 1980s will begin to have an impact [leading to improved relations]."[19]

Others have suggested that the shift in the public mood will begin to weigh on future policy. American policymakers, in particular, may feel compelled to develop a differentiated policy toward Japan. While Washington would continue to foster areas of close, mutually beneficial cooperation, the relationship would not be immune from forceful responses in cases where Japan's practices are seen as undercutting U.S. interests.[20]

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[17] Dorian Benkoil, "Better Misunderstood Than Ignored," Business Tokyo, August 1991, p. 41.

[18] Ibid., p. 41.

[19] Ronald A. Morse, "U.S.-Japan Relations: The Case for Optimism," Sekai Shuho, January 1-8, 1991.

Those who are predicting that U.S.-Japan relations are headed down a rocky road may be right. But given the economic and political values the two countries share, there still is enough of a reservoir of goodwill between them to ensure that relations do not veer off the road.

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[20] Robert G. Sutter, "Japanese Government Cooperation With The United States: U.S. Officials' Perspectives," CRS Report for Congress, April 24, 1990, p. 23.

For further information, contact Barbara Wanner.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

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Defense White Paper Urges Continued Vigilance

Although the Cold War era has come to a close, the Japan Defense Agency's 1991 white paper urged a continuation of current military spending levels and the maintenance of a close defense relationship with the United States. The white paper, released July 26, omitted for the second year in a row a decade-old reference to the "latent Soviet threat" to regional security. The agency noted, however, that continued vigilance is warranted because Moscow has made qualitative improvements to its Asian Pacific weaponry. Evidence also suggests that North Korea may be developing a nuclear capability, the white paper warned, a situation that potentially could destabilize the region. Perhaps most significant, JDA for the first time called on the Japanese public to consider what roles the Self-Defense Forces might play internationally, such as participating in United Nations-sponsored peacekeeping efforts. Until recently SDF's military mission was limited strictly to an area within 1,000 nautical miles of the home islands due to the government's long-held interpretation of the war-renouncing clause of Japan's "peace constitution."

The white paper acknowledged that the Soviet Union now is in a difficult position to stage aggressive action against other countries because of its domestic economic and political problems as well as the loss of a support network when its former satellites in Eastern Europe embraced political and economic reforms. But the situation in the Asian Pacific region is "more complicated"

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Tokyo already has initiated such an exchange under the auspices of the Japan International Cooperation Agency, which is responsible for coordinating Japan's public-sector technical assistance program. Later this month a JICA team is scheduled to visit Romania to identify areas where help would be beneficial, such as the environment and social infrastructure. Also at the end of August the first of a group of about 20 Romanians will arrive in Japan for technical training.

Mr. Nakayama's promises of additional technical assistance were seconded by Minister of International Trade and Industry Eiichi Nakao. The MITI official promised that Romanians would be included in training programs for Eastern Europeans conducted by Japanese companies in Europe and that later this year Japanese experts would be sent to Romania to help improve that country's productivity.

The Japanese government has been cautious about extending aid to Eastern Europe. The promising prospects of further assistance for Romania are tempered by Tokyo's announcement this spring that it planned to freeze new loans to Poland. The move to hold off on new commitments to Warsaw was in response to the decision of the so-called Paris Club of creditor countries to forgive half of Poland's government-to-government debt and reflected Tokyo's hopes of dissuading other debtor nations from requesting similar relief. Ministry of Finance officials, in particular, have expressed their dissatisfaction with debt forgiveness, which they feel engenders irresponsible attitudes toward repaying loans.

Margo Grimm

Japan's Current Account Surplus Jumps

First, the bad news for those concerned about Japan's large external payments imbalances with its trading partners. The surplus registered by the broadest measure of Japan's trade -- the current account -- jumped 136.6 percent in the second quarter of 1991 compared to a year earlier (see Table 1). Second, the good news: the same statistic. While the surging current account surplus reflected an increase in net exports of goods and services, it also meant that the long-dreaded slowdown in Japanese funds flowing overseas remains more threat than reality despite the ongoing problems in the Japanese stock market and economy.

The ballooning of Japan's current account surplus in the second quarter resulted from two major factors. First, its trade surplus grew significantly, a phenomenon reflected in the customs-clearance trade figures released earlier this summer (see JEI Report No. 28B, July 26, 1991). To a substantial extent the larger surplus reflects the year-to-year change in the yen's value against the dollar. In the April-June period compared to 1990's second quarter the yen strengthened substantially, lifting the dollar value -- although not the volume -- of exports. As long as the yen-dollar exchange rate maintains its mid-August range of Y135 to Y140=$1.00 the rise in the trade surplus initially will diminish then reverse over time as the stronger yen reduces exports and lifts imports. Second, the April-June services imbalance reflected the lingering effects of the Persian Gulf War; net travel payments dropped significantly in April and May compared to a year earlier but rebounded in June to their approximate 1990 level. Taken together, these two factors suggest that future

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1986	$92,827	$205,591	$112,764	$-4,932	$85,845	$-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1988	95,012	259,765	164,753	-11,263	79,631	-130,930
1989	76,917	269,570	192,653	-15,526	57,157	-89,246
1990	63,528	280,374	216,846	-22,292	35,761	-43,586
1989: I	21,311	66,945	45,634	-3,595	16,064	-5,612
II	19,794	66,560	46,766	-4,892	14,283	-30,801
III	19,770	68,157	48,387	-4,023	14,957	-21,559
IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990: I	14,393	65,460	51,067	-701	12,305	-16,086
II	13,614	65,510	51,896	-5,279	7,892	-18,985
III	17,149	70,500	53,351	-8,045	7,400	-7,247
IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991: I	20,729	74,978	54,249	-920	10,260	10,707
II(p)	22,994	71,943	48,949	-3,708	18,671	-6,931

quarters are not likely to reveal comparable year-to-year jumps in Japan's current account surplus.

In addition, the April-June figures suffered in comparison with the first-quarter data for a special reason. Japan's large contribution to the multinational effort in the Persian Gulf distorted the January-March data; without this special influence the first-quarter current account surplus would have been larger than the second-quarter one, other factors equal.

The larger current account surplus has had implications for Japan's outbound capital flow, to which it is conceptually equal. Table 2 shows Japan's international long-term securities transactions, one important element of short- and long-term capital flows. Since 1987 Japan's declining current account surplus has coincided with a drop in the net outflow of funds from Japan for the purchase of long-term securities. One factor since late last year has been renewed foreign interest in the Japanese stock market, peaking at $17.5 billion in net purchases in the first quarter of this year. In the last quarter of 1990 and the first quarter of 1991, the overall figure for foreign purchases in Japan exceeded Japanese purchases abroad, but a strong recovery of overseas Japanese stock and bond activity reversed the situation during the second quarter.

While the jump in the current account surplus in the second quarter reflected a series of one-time events, few analysts expect that the surplus will decline significantly in coming quarters. Most recent estimates put the 1991 surplus at between $41 and $45 billion, values that may be somewhat too low in

Table 2: Japan's Net International Long-Term Securities Transactions

(in millions of dollars)

	Net Japanese Purchases			Net Foreign Purchases			Net
	Bonds	Stocks	Other*	Bonds	Stocks	Other**	Outflow
1986	$-93,024	$-7,048	$-1,905	$-2,109	$-15,758	$18,412	$-101,432
1987	-72,885	-16,874	2,002	6,675	-42,835	30,079	-93,838
1988	-85,812	-2,993	1,856	-21,628	6,810	35,116	-66,651
1989	-94,083	-17,887	-1,208	2,400	6,998	75,746	-28,034
1990	-28,961	-6,256	-4,464	16,991	-13,276	30,938	-5,028
1989: I	-14,003	104	577	-1,646	9,004	16,212	10,248
II	-25,091	-6,108	-776	-587	-6,196	27,501	-11,257
III	-25,871	-4,795	722	5,403	757	14,123	-9,661
IV	-29,118	-7,088	-1,731	-770	3,433	17,910	-17,364
1990: I	-869	-4,946	717	6,182	-11,713	8,246	-2,383
II	-9,353	-2,153	-954	4,975	838	723	-5,924
III	-10,905	-459	-2,405	4,790	-3,380	10,485	-1,874
IV	-7,834	1,302	-1,822	1,044	979	11,484	5,153
1991: I	-13,356	463	-1,348	1,418	17,486	9,129	13,792
II(p)	-22,423	-2,840	-1,353	6,348	4,140	11,831	-4,297

*Yen-denominated bonds issued in Japan.
**Bonds issued outside of Japan by Japanese institutions.

Note: For outflows, a minus (-) sign indicates an increase in assets abroad. For inflows, a positive value indicates an increase in Japanese liabilities to foreigners.

light of the latest figures. Almost certainly Japan's current account surplus will be higher than 1990's, which was the lowest figure since 1984. Whether Americans regard that prospect as good or bad depends in part on whether they put more emphasis on a continued supply of foreign capital or reductions in Japan's imbalance in trade of goods and services.

Douglas Ostrom

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JEI

REPORT

A Two-Part Report: A and B

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EPA Sees Smooth Seas, Bigger International Role For Japan

The Economic Planning Agency is sanguine about the future course of the Japanese economy and urges the nation to make good use of this prosperity by shouldering greater international responsibilities. EPA's 1991 economic white paper, released August 9, pointed to the Japanese economy's resilience and buoyancy over the past several years as it adjusted to the appreciation of the yen against the dollar, the distortions of the real estate and stock markets from over-inflated prices, and higher oil prices caused by the Persian Gulf War. With the economy comfortably at "cruising speed," EPA said, "Japan should take leadership in the maintenance and development of international common property," such as the General Agreement on Tariffs and Trade and the International Monetary Fund. This year's white paper, entitled "Conditions for Long-Run Expansion and Japan's International Role," is notable for its internationalist tone.

With regard to the domestic economy, the 1991 white paper highlighted the following developments:

- Overall economic growth is slowing to a moderate but sustainable pace. The current expansion, which is listed as beginning in December 1986,

Conference On Africa Set For Tokyo

Top officials and business leaders from Japan, the United States and several African nations will meet in Tokyo later this month to consider coordinated responses toward African development needs. The August 29-30 meeting will be the first of three conferences sponsored by Keidanren (Japan Federation of Economic Organizations), the New York-based African-American Institute and the Foundation for Advanced Studies on International Development, established last year with backing from Keidanren and the Ministry of Foreign Affairs. Some of the event's organizers say they hope that it will strengthen communication between public- and private-sector leaders from the countries involved and remain an effective forum for future dialogue.

Foreign Ministry officials report that Botswana's Minister of External Affairs Gaositwe Chiepe, Namibia's Minister of Foreign Affairs Theo-Ben Gurirab and Uganda's Minister of Foreign and Regional Affairs Paul Ssemogerere will participate in the conference, the first of its kind. The African National Congress' secretary for international affairs, Thabo Mbeki, also is scheduled to attend. Among the American representatives expected are Herman Cohen, assistant secretary of the Department of State's Bureau of African Affairs, and Rep. Mervyn Dymally (D, Calif.), chairman of the House Committee on Foreign Affairs' subcommittee on Africa. Japanese attendees will include several Diet members, high-level officials from the Export-Import Bank of Japan and Japan's aid agencies, Foreign Ministry officials and Keidanren leaders, including those representing the organization's interests in African and development issues.

While the Tokyo conference will focus on recent political developments throughout Africa and the economic consequences of these changes, special emphasis will be given to the part the private sector can play in Africa's economic development. Debt issues, regional cooperation and possible steps toward future collaboration among the United States, Japan and African nations also are on the agenda. Another expected discussion topic is the role of multilateral financial institutions in African development.

Vivian Derryck, president of the African-American Institute, notes that her organization's concerns with African development prompted the decision to talk with other major actors in the development field and eventually led to a meeting with Keidanren representatives. She points out that nongovernmental organizations and business groups in both donor and recipient countries could provide a good bridge to trilateral cooperation.

Conference planners expect to follow up with two other meetings scheduled roughly one year apart. The second, slated for the United States, also will focus on how the private sector can make a difference in economic development in Africa. The structure of the third conference will depend on the interests of the African nations involved in the dialogue, the pace of change and the "economic absorptive capacity in Africa," Ms. Derryck said.

In exploring aspects of official development assistance to Africa, the Tokyo conference will look in particular at areas for U.S.-Japan cooperation and the question of aid conditionality, organizers say. Japan, which traditionally has focused its bilateral ODA on Asia, in recent years has felt compelled by international expectations and the severe economic difficulties faced by many African nations to boost both the level and the grant portion of its bilateral aid to Africa. The region's share of Japanese bilateral aid has grown steadily since the mid-1980s, reaching 15.3 percent in 1989, the latest year for which data are available (see Table). In 1989, moreover, 37.7 percent of all Japan's grant aid (excluding technical assistance) went to Africa. Two years ago Tokyo announced that over a three-year period beginning in FY 1990 it would extend roughly $600 million of nonproject grant assistance to bolster economic restructuring, mostly in African nations. A similar program channeled approximately $500 million in nonproject grant aid to 26 African countries between FY 1987 and FY 1989.

Japan's Bilateral ODA to Africa, 1985-89

(in millions of dollars; net disbursements)

	1985	1986	1987	1988	1989
Africa	$252	$418	$516	$884	$1,040
Share of Total Bilateral Aid	9.9%	10.9%	9.8%	13.8%	15.3%
Total Bilateral Aid	2,557	3,846	5,248	6,422	6,779

Source: Ministry of Foreign Affairs

The Japanese government plans to hold a conference in 1993 that will bring African leaders together to discuss the development problems that face their nations. Japanese businesses, as well, already have been taking a closer look at a variety of issues relating to trade and investment in Africa. In April, for example, Keidanren sent a mission to South Africa to examine social and economic conditions in that country (see JEI Report No. 19B, May 17, 1991). Developments in South Africa can be expected to be among the topics examined at the upcoming Tokyo meeting, which will provide a forum for participants representing a wide range of views on and interests in Africa.

Margo Grimm

ITC Clears Dumping Duties On Flat Panel Displays

Defying the expectations of many trade watchers, the International Trade Commission voted three-to-one August 15 that U.S. manufacturers of flat panel displays are being hurt by sales of some types of competing Japanese-made products sold here for less than at home. On paper the injury ruling provides a much-needed shot in the arm for the handful of American companies eyeing the commercial market for thin computer screens since it cleared the way for the imposition of stiff (62.67 percent) antidumping duties on made-in-Japan displays incorporating active-matrix liquid crystal display technology. That gives domestic makers protection from Japanese competition in the type of display expected to be used increasingly in the future in portable computers as well as

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REPORT

A Two-Part Report: A and B

NO. 33A

August 30, 1991

WOMEN IN JAPAN'S WORK WORLD SEE SLOW CHANGE FROM LABOR SHORTAGE, EQUAL EMPLOYMENT LAW

Summary

Conditions would appear ripe in Japan for women to feel just a bit smug about their importance to the economy. Calls for hiring more women have sounded forth from government offices as one way of helping Japan survive what demographers project as a long-term labor shortage. Moreover, women's cooperation definitely is needed if the fertility rate is going to stop shrinking and return to a level capable of population replacement. The government has taken steps to encourage the hiring of more women as well as the birth of more babies, a seemingly contradictory action in a country where a majority of young mothers remain outside the labor force.

Yet, despite a significant number of working women in Japan, workplace and societal conditions are such that female employment remains one of the cushions by which businesses survive the economy's ups and downs. Even with legal guarantees of equality, constraints remain on employment opportunities for women, often in the name of protection. Women's support groups generally place more importance on health and safety issues than on strict equality in employment, at least as understood from an American perspective. And, although the government preaches equality for women, its own hiring and promotion practices fall short, as does its advocacy of private-sector compliance with equal employment opportunity laws.

As Japan works to upgrade its citizens' standard of living and lessen international criticism about the workaholic Japanese employee, structural changes could begin to benefit the working woman. Among current roadblocks to equal participation are the

seniority system, the use of extensive overtime and a reliance on part-time or temporary workers whose jobs often are the first to go in times of economic downturn. Economic necessity might produce some adjustments in these management practices, but fundamental change will not occur without changes in both men's and women's attitudes toward work, leisure and child care. Such changes may go beyond what the Japanese as a people consider prudent or necessary. These are matters of concern not only for Japan; the spread of Japanese-owned businesses overseas indicates that Japanese employment practices have the potential to influence personnel decisions in other countries.

More Women Working

Women's participation in Japan's labor market has grown from 45.7 percent in 1975 to 50.1 percent last year, meaning that almost half of all women over the age of 15 were looking for a job or doing some form of work that allowed them to be counted as employed. Among the reasons for this increase is what many Japanese analysts call a different life cycle, one in which women marry later and return to work sooner after having children. Others point to more job opportunities as well as a heightened awareness of the work world because more women are graduating from high school and entering a two- or a four-year college. Some observers also point to economic rationales.

The analysts who attribute the growing number of women in the work force to the life-cycle theory note that today's woman is marrying at 25 or 26, whereas her counterpart from about 40 years ago married at age 23 or so. This allows more time to work between school and marriage or the birth of the first child, which usually occurs about a year after marriage. If a woman has a second child, typically this will be by age 29. The shrinking fertility rate, 1.53 in 1990, means that fewer Japanese women are having two children. Thus, by the time a woman is in her late 30s or early 40s she may be working outside the home while her child(ren) is (are) in school.

This theory rests heavily on the notion that Japanese women traditionally drop out of the labor force to have children and stay at home with them until they are in school. But even this traditional view has changed somewhat. Until fairly recently mothers were expected to be available at home for their children throughout their educational life. Now an estimated 35.8 percent of mothers whose youngest child is 6 years old or less are in the work force, while up to 65 percent of mothers with a youngest child aged 7 to 14 is working; the employment figure for mothers whose youngest is aged 15 to 17 is 70.6 percent. In 1987 the comparable participation rates were 34.1 percent, 59 percent and 66.8 percent, respectively.

Women 35 and older constitute the majority of the women in Japan's labor force, 66.9 percent in 1990. Most members of this age group do not work because they are the sole family support; the majority has a husband, who, presumably,

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works. About 10 percent of this age group, however, never has been married; thus, these women seek employment opportunities that give them a decent living. A similarly small percentage represents women who are heads of household, a reflection of Japan's low divorce rate (1.28 per 1,000 people in 1990) and the limited number of widows in the working-age group. (A 1988 survey indicated that about 30 percent of the 849,000 single-parent households had lost a father through death; the remaining 70 percent resulted from divorce.)

In slightly less than three-quarters of the divorces mothers receive custody of the children; a 1989 Ministry of Health and Welfare study said these women averaged about two-fifths the income of households in which a father is present -- Y2.27 million or $16,800 a year at Y135=$1.00 compared to Y5.45 million or $40,400. Public assistance for mothers and children in 1989 went to roughly 4 percent of the households listed that year as containing one parent and offspring.

The rising cost of living, however, does play a role in encouraging housewives to work, according to Hisako Hirota, a professor at Japan Women's University. Writing that the "stay-at-home housewife has become, by and large, economically unfeasible," Ms. Hirota also stated, "The development of Japan's economy has created not only a demand for cheap housewife labor but also a demand by the housewives themselves for work."[1]

Yet, even if economic necessity plays a role, the perception in Japan is that women workers as a whole are a supplementary source of household income. Supplemental also has been the primary label for their role in the business world. That image is changing, partly as a result of the current labor shortage but also because more women view work as an important part of their lives. What often is overlooked, however, is whether good employment opportunities are available to women.

Avenues of Employment

Japan's strong manufacturing and service sectors have provided women with an increasing source of employment, as can be seen in Tables 1 and 2. The opportunities in 1989 (the latest data available for a broad range of gender-based analysis) included more work in big manufacturing companies, although small and midsized manufacturers not only continued to hire a larger percentage of women but had a better balance in new hirees between men and women (see Table 3). Similarly, large service-sector firms, while employing added numbers of women, continued to lag behind their small and medium-sized counterparts, which in recent years consistently have hired more women than men.

A plurality of women (33.5 percent of all female employees in 1989) work in wholesale and retail trade (including restaurants and bars), finance, insurance or real estate. If the services category (which covers hotels, information services, advertising, recreation and miscellaneous repair shops) is included, the majority of female employees (64.4 percent) would be represented. Manufacturing comes in a strong third, employing slightly more than one-fourth (26.5 percent in 1989) of all female employees.

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[1] Hisako Hirota, Japanese Women Today (Tokyo: International Society for Educational Information, 1988), p. 3.

Table 1: New Hires by Selected Industries, 1987-89

	Manufacturing			Finance, Insurance and Real Estate			Services		
	1987	1988	1989	1987	1988	1989	1987	1988	1989
New Hires	1,212,200	1,433,600	1,428,400	271,600	317,700	305,800	946,300	1,176,800	1,081,500
Males	628,100	777,000	765,300	67,500	79,300	75,600	379,100	499,300	438,400
Part-time	26,800	34,100	27,600	800	300	1,800	31,200	63,600	41,100
Females	584,100	656,700	663,100	204,100	238,200	230,200	567,200	677,600	643,100
Part-time	206,000	216,900	209,900	31,500	18,600	19,800	101,300	157,100	132,000
Openings	1,361,573	1,893,126	2,112,446	118,325	116,470	121,884	837,066	1,241,640	1,072,484
Temporary	141,672	175,844	176,239	2,621	2,969	2,281	57,893	60,000	61,473
Regular	1,219,901	1,717,282	1,936,207	115,704	113,501	119,603	779,173	1,181,640	1,011,011

Source: Ministry of Labor, Yearbook of Labor Statistics.

Table 2: Newly Hired Employees by Selected Industry, Gender and Age, 1987-89

		Manufacturing			Finance, Insurance and Real Estate			Services		
		1987	1988	1989	1987	1988	1989	1987	1988	1989
Total		1,212,200	1,433,600	1,428,400	271,600	317,700	305,800	946,300	1,081,500	1,176,800
Male	Under 20	129,500	155,700	167,400	3,200	1,700	3,800	38,100	54,000	52,600
	20-24	149,700	181,400	186,100	27,500	33,900	38,500	104,800	112,200	140,500
	25-29	67,300	89,600	92,100	4,800	9,900	11,200	65,600	63,900	77,200
	30-34	48,800	74,600	68,700	5,100	8,400	4,200	42,500	42,900	49,300
	35-44	87,500	122,200	111,200	9,400	10,300	[illegible] 100	49,000	50,500	62,000
	45-54	71,600	89,100	81,100	8,500	10,200	[illegible] 700	30,400	45,400	38,500
	55-59	34,800	40,100	36,000	6,800	2,500	4,600	20,400	32,100	30,100
	60 and Over	22,100	24,400	22,700	1,900	2,500	1,400	23,100	37,500	49,100
Female	Under 20	124,200	124,600	126,700	29,200	18,600	22,200	86,000	95,000	82,400
	20-24	101,000	126,100	131,700	50,500	54,000	62,200	199,800	198,600	222,800
	25-29	45,000	53,600	54,500	27,600	34,500	29,300	77,200	86,200	79,000
	30-34	62,800	66,300	64,100	28,100	39,000	46,500	41,400	48,200	52,000
	35-44	153,700	171,500	165,800	44,700	70,900	53,300	73,400	92,300	111,100
	45-54	78,600	91,600	98,300	19,000	17,200	14,100	54,300	75,700	77,500
	55-59	13,000	16,000	14,500	3,700	4,000	2,000	20,000	25,500	28,900
	60 and Over	5,900	6,900	7,500	1,200	200	600	15,000	21,500	23,900

Source: Ministry of Labor, Yearbook of Labor Statistics.

Table 3: Newly Hired Employees by Size of Firm and Gender for Selected Industries, 1987-89

(in thousands)

		Manufacturing					Finance, Insurance and Real Estate					Services				
		5-29	30-99	100-299	300-999	1000+	5-29	30-99	100-299	300-999	1000+	5-29	30-99	100-299	300-999	1000+
1987:	Male	183.1	133.7	130.0	72.1	108.9	7.1	5.5	5.7	10.5	35.7	107.8	64.8	81.0	49.7	39.6
	Female	145.8	131.3	151.9	63.6	91.5	10.8	6.0	8.3	21.9	155.2	170.9	93.3	130.2	62.4	36.8
1988:	Male	177.0	181.1	148.9	110.2	159.4	17.9*	5.9	11.3	13.6	28.9	111.4	82.3	104.4	56.1	57.1
	Female	132.4	174.9	147.7	105.6	95.2	10.6	15.6	15.4	12.9	181.5	173.0	132.7	152.5	86.6	46.8
1989:	Male	138.6	169.3	130.9	113.3	212.8	7.2	6.0	15.8	11.0	34.7	142.0	100.5	101.6	63.1	58.6
	Female	137.4	164.1	146.8	107.4	106.2	11.6	10.6	6.8	13.6	186.0	197.5	136.4	159.2	82.4	49.7

Source: Ministry of Labor, Yearbook of Labor Statistics.

Not all women who are in the labor force draw a paycheck per se. For example, the mom-and-pop shopkeepers and other family workers (8.3 percent of all workers were categorized in 1990 as family workers, and of these 82.3 percent were women) might not receive wages, but they still figure into the work force. Also included are those under contract for jobs inside the home, such as piecework for factories. Tutoring in various studies may be included, but in her book on Japanese women workers Mary Saso noted that Japanese data probably are on the low side since many women do not describe as "employment" their tutoring, calligraphy or other types of work that often are paid for through a discreetly offered envelope.[2]

Thus, a majority of women over the age of 15 count as members of Japan's labor force; most of these are employees. That is not a new phenomenon (see Table 4). What is significant is the slow but steady growth in the number of women who are regular employees (see Table 5).

Putting More Women To Work

As of June 1991 women made up 41.2 percent of Japan's labor force. That compared with 39.8 percent in 1986 when unemployment reached levels considered high in Japan. The higher ratio this year is not surprising given the current tight labor market. For example, the job-opening-to-applicant ratio has been above 1 since May 1988; in June it was 1.43, meaning that 143 jobs were available for every 100 job seekers.

Significantly, the 1.4 percentage point difference in the share of the labor force represented by women parallels a post-1986 increase in regular jobs held by women. Employers have two main hiring options: either employing more people in regular jobs or using extra part-time and/or temporary workers. A temporary worker is hired for a predetermined time and, except for not receiving some fringe benefits, may work in positions similar to those of regular workers. Part-time status, too, may be little more than an empty description, although part-timers technically work under 35 hours a week.

Among the biggest fans of part-time and temporary work are married women, especially those with children. An estimated 53.7 percent of Japanese mothers work outside the home. Of these, 31 percent had part-time jobs, while 22.7 percent worked full-time, according to 1988 figures from the Management and Coordination Agency. Similarly, a 1988 Ministry of Labor summary of labor market conditions for women noted that 41.5 percent of the jobs held by married women in 1987 were part-time or nonpermanent jobs. A recent employment firm survey of housewives aged 20-29 showed that although 15.4 percent said they would like regular employment, 74.8 percent of those interviewed said they preferred part-time work to give them more time at home. The magazine that reported the survey, Torabayu, noted that the prevalence of part-time work has encouraged more women to enter, or return to, Japan's labor force.[3]

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[2] Mary Saso, Women in the Japanese Workplace (London: Hilary Shipman, 1990), p. 4.

[3] "Minna Dou Shite Ritaan Suru No?" ("Why are women returning to work?"), Torabayu, No. 28, July 26, 1991, pp. 6-8.

Table 4: Women Employees, Family Workers and Self-Employed, 1985-89

(in thousands)

	Nonagricultural Industries			Agriculture		
	Employees	Family	Self-Employed	Employees	Family	Self-Employed
1985	15,390	2,790	2,480	90	1,820	410
1986	15,740	2,780	2,460	110	1,740	400
1987	16,040	2,820	2,450	100	1,730	390
1988	16,600	2,810	2,450	110	1,670	380
1989	17,380	2,760	2,450	110	1,610	360

Source: Ministry of Labor, Yearbook of Labor Statistics.

Table 5: Women Workers by Employment Status by Industry, 1987-89

(in thousands)

Industry	Year	Total	Employees Regular	Employees Temporary	Self-Employed	Family
Manufacturing	1987	5,590	3,420	690	810	500
	1988	5,710	3,520	700	810	490
	1989	5,900	3,720	700	840	470
Trade and Finance*	1987	7,630	4,240	950	770	1,460
	1988	7,800	4,390	980	750	1,450
	1989	7,950	4,550	1,040	720	1,400
Services	1987	6,310	4,130	660	850	530
	1988	6,520	4,280	690	870	530
	1989	6,780	4,470	750	870	540
Government	1987	340	250	70	--	--
	1988	330	240	70	--	--
	1989	330	240	70	--	--

*Includes wholesale and retail trade, eating and drinking establishments, finance, insurance and real estate.

Source: Ministry of Labor, Yearbook of Labor Statistics.

Employers like to hire part-time and temporary workers, in part because of the flexibility this type of staffing gives them to cope with business fluctuations but mainly because part-time and temporary employees cost less in terms of wages and benefits. Professor Hirota of Japan Women's University noted in a 1988 report that the main employers of part-time workers are small companies, which also pay lower wages than bigger firms to their full-time employees. As an example of the differences between company size and pay for full- and part-time workers, she suggested that a part-timer would get the equivalent of 67 percent of a full-time worker's pay at a large company. At a medium-sized firm a full-time worker would get 72 percent and a part-timer 54 percent of a full-time employee's pay at a big firm, while in small businesses a full-time employee might get 60 percent and a part-timer 52 percent of the pay enjoyed by a full-time worker at a large firm.[4]

Despite the attractions of part-time and temporary work for both employers and married women, the number of women employed as regular workers rose 1.1 percentage points between the economy's slow growth year of 1986 and 1989, the third full year of the current economic expansion. In 1989 females filled 33.7 percent of Japan's regular full-time jobs compared with 32.6 percent in 1986 when the country's Equal Employment Opportunity Law went into effect.

The growth in regular jobs for women indicates that the "cushion effect" may be losing some of its firmness, especially if a recent decline in women's share of the market for part-time and temporary jobs is not just an aberration. The "cushion effect" theory contends that women, who typically hold the majority of part-time and temporary jobs, bear the brunt of layoffs, thus providing the cushion for business ups and downs. But, while part-time and temporary positions as a percentage of new hires and overall employment are growing, women's share in both has slipped since 1986. That year temporary workers accounted for 5.5 percent of all employment, and women held 73.7 percent of these nonpermanent jobs. Part-time positions in 1986 represented 20.7 percent of all new hirings, and women filled 80.6 percent of these slots. In 1989 women's share of the 6.1 percent of all jobs that were temporary was 72.6 percent. Part-time hirings as a percentage of all newly filled positions ran at 22 percent, of which women made up 78.7 percent. One explanation of the lower shares for women is that more men appear to be attracted to the flexibility of working in a temporary or part-time job. In its 1991 annual report on labor market conditions the Ministry of Labor contended that the continued growth in part-time jobs throughout Japan corresponds to increased interest in a more enjoyable life-style rather than the demands of a lifetime career.

Pay Differentials and Other Issues

"Equal pay for equal work," recognized in principle by the 1947 Labor Standards Law, carries little clout as a rallying cry for employment equality since, like here, job descriptions in Japan often obscure the concept of equal work. The pay picture, too, is cloudy since take-home pay depends on various components -- educational background, seniority and overtime as well as a system of bonuses and benefits that corresponds somewhat to each worker's individual situation (see JEI Report No. 40A, October 19, 1990). In almost every part of the private sector a woman's average monthly pay (which excludes bonuses and overtime as well as supplemental benefits) ranks well below that of a male employee.[5] This is true, on average, even when educational levels and the time spent working are similar. Graphs 1-5 show the disparities in various parameters for a large company, defined as a firm with 1,000-plus employees. The averages, however, fail to take into account differences between job categories within the firm and may be distorted by various other factors, such as the number of managers in a given category that are male or female. Nevertheless, the figures give a base for comparison. Of particular interest are the nearly equal starting pay levels for senior high graduates across all industries. Only in the services sector does that degree of pay equity last into the early 20s.

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[4] Hirota, op. cit., p. 8.

[5] In a study paper submitted to the Joint Economic Committee, Congress of the United States, M. Anne Hill estimated that the average female employee in Japan earned almost half (51 percent) of the average male worker's pay in 1988, which was down from a high of 56 percent in 1978. The growth in the female labor force, she noted, was accompanied by a drop in earnings vis-a-vis male counterparts. M. Anne Hill, "Women in the Japanese Labor Force," Japan's Economic Challenge (Washington, D.C.: Government Printing Office, 1990), pp. 262-263.

Shortfall in Higher Education - Several conjectures are possible on the inconsistencies between wages and years worked. One is that fewer women than men in a particular industry might have a college education; thus, they would have lower average pay. A 1990 report by the Japan Institute of Women's Employment noted, for example, that a woman with a high school education might receive only 75.7 percent of the pay of her college-educated counterpart. The report further said that college graduates comprised 24.1 percent of the male work force, whereas college graduates made up only 4.8 percent of the ranks of female workers.[6] A greater percentage of women (95.6 percent in 1990) than men (93.2 percent) entered the noncompulsory upper grades of high school, but fewer women than men go on to enroll in four-year colleges. In 1990 women heading to junior college numbered 22.2 percent of female high school graduates; 15.3 percent of the female graduating class went to a four-year college. More than twice as many male high school graduates (33.4 percent) enrolled in a four-year college that year; only 1.7 percent went to a junior college. In 1989 men outnumbered women on college campuses by almost 3-to-1, but female enrollments are rising.[7]

What cannot be determined from Table 6 is whether a career woman is paid the same as her male colleague for a similar job, given equivalent educational backgrounds. This situation reportedly occurs in government employment, but data for the private sector are difficult to find. In principle, however, the law forbids pay discrimination based on gender for equal work.

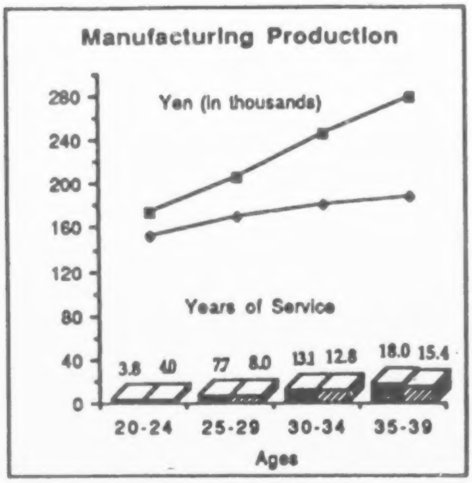
Dropout Rate and Seniority - One of the often-cited reasons for women generally earning less than men is that they fail to achieve seniority through an unbroken employment record, an achievement that wins high marks in a seniority-based employment system. Although Japanese career women do marry and have children, the typical female employee often is considered one who will quit work to have children, stay home with them at least until they enter school and then reenter the work force. This pattern is dramatically evident in the "M" shape that depicts women's labor force participation rates in Japan (see Graph 6). The 75.1 percent participation rate of women aged 20 to 24 in 1990 dipped to a low of 51.7 percent for those aged 30 to 34 before rising to another peak of 71.7 percent among those aged 45 to 49. At age 50 women once again begin to drop out of the labor force (see Table 7).

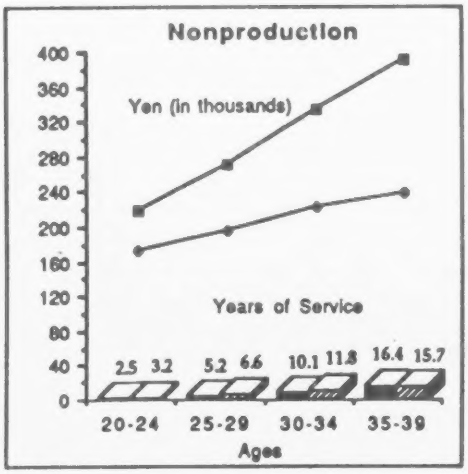
The Ministry of Labor's 1991 white paper on labor, which noted that 1990 employment figures showed fewer women in the 30-34 age bracket dropping out

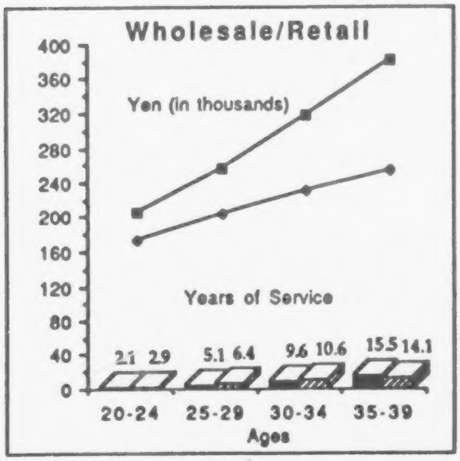
[6] Japan's Working Women Today (Tokyo: Japan Institute of Women's Employment, 1990), pp. 10-11.

[7] Japanese Women Yesterday and Today (Tokyo: Foreign Press Center, 1991), p. 11.

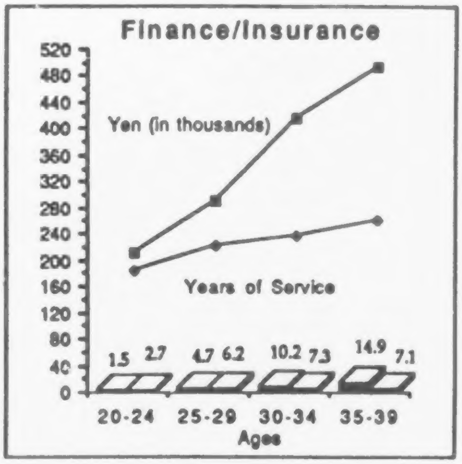
Graphs 1-5: Monthly Wa[illegible], Age and Years of Service for Japanese Men and Women

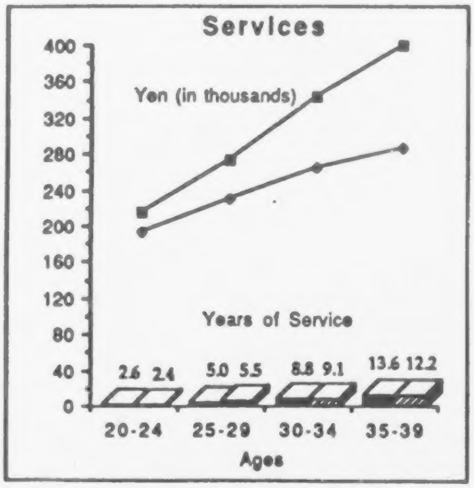






■ Male Duration of Service
■ Female Duration of Service
–■– Male Total Contract Earnings
–◆– Female Total Contract Earnings





Source: Ministry of Labor

Table 6: Employee Profiles for Firms with One Thousand or More Employees, 1989

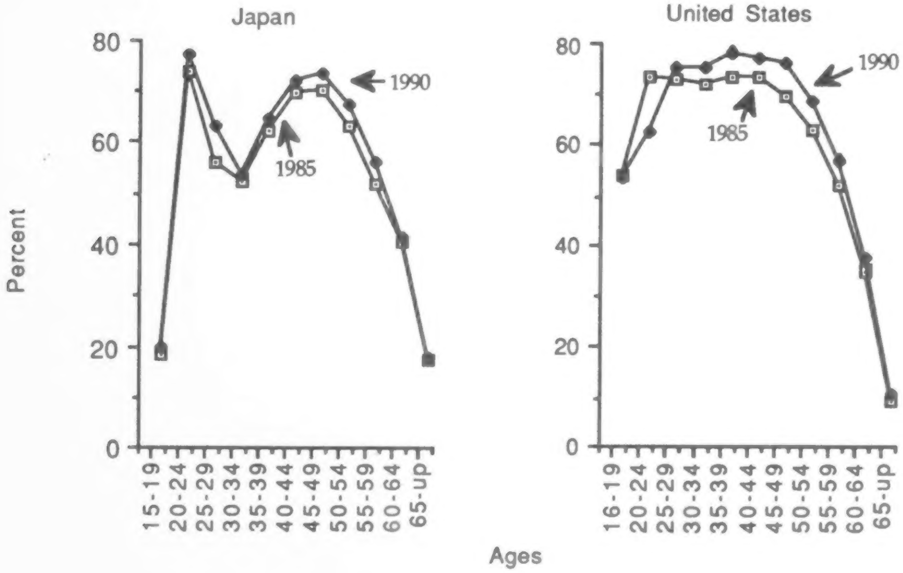
(in thousands of yen and thousands of persons)

	Senior High		Junior College		College/University		Ages 20-24		Ages 25-29		Ages 30-34		Ages 35-39		Ages 40-44	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
Manufacturing: Production																
Average Age	35.0	35.9	--	--	--	--	22.6	22.4	27.3	27.1	32.7	32.4	37.6	37.6	42.3	42.2
Duration of Service	10.5	6.6	--	--	--	--	3.8	4.0	7.7	8.0	13.1	12.8	18.0	15.4	21.2	15.1
Scheduled Hours	176	181	--	--	--	--	165	170	164	170	164	168	163	170	163	170
Unscheduled Hours	30	9	--	--	--	--	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Scheduled Earnings/Month	Y222.4	Y130.6	--	--	--	--	Y166.6	Y145.3	Y198.4	Y162.7	Y238.2	Y174.3	Y271.9	Y181.5	Y296.9	Y175.2
Contract Earnings/Month	Y272.6	Y139.4	--	--	--	--	Y220.2	Y159.4	Y259.4	Y175.5	Y305.9	Y188.7	Y346.9	Y198.7	Y377.2	Y191.9
Average Starting Wage/Month*	Y128.4	Y123.0	--	Y135.1	Y162.7	--										
Ratio of New Grad Hires	77.5		6.2		12.4											
Manufacturing: Nonproduction																
Average Age	40.4	31.5	35.5	26.9	37.3	29.2	23.3	22.7	27.4	27.9	32.4	32.3	37.7	37.4	42.4	42.2
Duration of Service	16.7	7.2	11.3	4.5	12.1	5.0	2.5	3.2	5.2	6.6	10.1	11.8	16.4	15.7	20.9	18.1
Scheduled Hours	177	179	176	174	173	171	170	169	169	166	168	166	167	167	168	168
Unscheduled Hours	20	9	24	9	18	12	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Scheduled Earnings/Month	Y303.5	Y161.8	Y276.5	Y162.8	Y329.9	Y201.6	Y170.3	Y152.2	Y207.9	Y199.6	Y264.1	Y199.6	Y323.1	Y212.9	Y384.7	Y232.4
Contract Earnings/Month	Y340.7	171.3	Y315.0	Y173.3	Y362.7	Y219.5	Y208.5	Y163.4	Y260.6	Y214.9	Y324.5	Y214.6	Y382.6	Y229.9	Y431.7	Y251.3
Wholesale and Retail Trade																
Average Age	37.4	28.3	33.7	26.2	35.8	26.9	23.1	22.5	27.4	27.0	32.4	32.4	37.7	37.5	42.1	42.1
Duration of Service	16.2	7.1	11.7	5.0	11.9	4.0	2.1	2.9	5.1	6.4	9.6	10.6	15.5	14.1	19.0	14.2
Scheduled Hours	174	171	175	168	171	168	174	171	174	168	174	165	173	168	171	169
Unscheduled Hours	16	8	20	10	12	11	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Scheduled Earnings/Month	Y313.3	Y170.5	Y278.8	Y176.8	Y343.1	Y191.6	Y172.3	Y154.1	Y214.8	Y181.8	Y276.0	Y209.8	Y343.6	Y225.4	Y414.4	Y222.3
Contract Earnings/Month	Y339.9	Y180.7	Y310.9	Y190.9	Y365.0	Y207.1	Y196.9	Y164.1	Y246.4	Y195.2	Y308.2	Y222.8	Y372.2	Y243.9	Y434.8	Y236.6
Average Starting Wage/Month	Y126.0	Y123.8	--	Y135.9	Y161.4	--										
Ratio of New Grad Hires	44.8		16.6		33.0											
Finance and Insurance																
Average Age	43.6	37.7	43.9	27.9	36.0	29.6	23.7	22.5	27.4	27.1	32.6	32.5	37.5	37.6	42.4	42.2
Duration of Service	20.2	7.9	14.5	4.5	12.0	3.6	1.5	2.7	4.7	6.2	10.2	7.3	14.9	7.1	19.6	7.2
Scheduled Hours	157	152	155	153	157	155	158	156	158	154	157	151	157	150	157	149
Unscheduled Hours	12	5	9	11	14	10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Scheduled Earnings/Month	Y430.1	Y245.0	Y382.2	Y195.3	Y397.2	Y220.3	Y176.1	Y156.7	Y241.2	Y192.1	Y354.8	Y212.7	Y436.7	Y241.2	Y506.1	Y282.8
Contract Earnings/Month	Y463.4	Y253.6	Y401.7	Y210.3	Y429.1	Y235.1	Y198.2	Y171.3	Y278.7	Y210.4	Y403.2	Y225.5	Y480.5	Y249.3	Y536.9	Y287.8
Average Starting Wage/Month	Y122.0	Y117.4	--	Y133.1	Y155.9	--										
Ratio of New Grad Hires**	23.0		28.3		44.7											
Services																
Average Age	37.6	32.4	34.7	29.5	36.9	30.9	23.0	22.7	27.4	27.1	32.6	32.3	37.5	37.6	42.2	42.4
Duration of Service	13.6	8.1	10.1	6.4	11.2	6.7	2.6	2.4	5.0	5.5	8.8	9.1	13.6	12.2	17.8	12.7
Scheduled Hours	170	169	169	166	164	165	170	167	166	165	167	164	168	167	165	170
Unscheduled Hours	22	10	21	11	18	11	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Scheduled Earnings/Month	Y285.7	Y193.0	Y266.3	Y210.8	Y370.1	Y244.8	Y170.4	Y164.6	Y215.1	Y195.8	Y280.5	Y231.7	Y345.1	Y254.0	Y408.8	Y255.8
Contract Earnings/Month	Y322.7	Y210.7	Y305.0	Y238.1	Y410.9	Y266.8	Y206.2	Y185.7	Y264.5	Y221.2	Y335.5	Y256.7	Y390.7	Y279.1	Y443.1	Y277.3
Average Starting Wage/Month	Y128.1	Y123.6	--	Y137.7	Y165.6	--										
Ratio of New Grad Hires	27.5		20.0		36.3											

*All manufacturing workers.
**Includes real estate.

Source: Ministry of Labor, Yearbook of Labor Statistics.

Graph 6: Women in the Labor Force, 1985 and 1990



Source: Ministry of Labor and Department of Labor

(participation topped 51.7 percent comapred with 51.2 percent in 1989), cited the demands of child care as the main reason women in that age group quit work. Past MOL surveys indicate that very few women actually list maternal matters as their reason for quitting work (see Table 8). The primary reason given, "one's own convenience," raises questions about whether women felt compelled to keep their reasons private or whether some hesitated to admit taking a traditional approach. Nevertheless, most analysts contend that women by and large quit work for family reasons.

Protectiveness - The dual concern of government for equal employment opportunities and preservation of the family collide on the question of whether limits on the number of hours worked are appropriate for female employees. What this means in practice is that a woman's opportunities to earn more money and collegial goodwill by working overtime are severely restricted. (Graph 7 depicts the additional earnings possible from overtime.) These restrictions do not affect women holding professional and managerial posts or those employed in certain occupations for which exemptions are granted, including technical positions. The government contends that working women would suffer if no limits were placed on working hours since "women presently bear most of the burden of housework, child care, and other housekeeping duties."[8]

In manufacturing nonmanagerial women -- even those who are unmarried and presumably have fewer family obligations -- are prohibited from working on holidays, as are those in the health, sanitation, hotel, food, entertainment and

[8] Japan's Working Women Today, op. cit., p. 21.

Table 7: Women's Labor Force Participation Rate by Age, 1984-89*

(in millions)

	Total Population	20-24		25-29		30-34		35-39		40-44		45-49		50-54		55-59		60-64		65+	
		Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force	Population	Labor Force
1984	120.05	3.92	2.84 (2.70)	3.93	2.12 (2.02)	4.82	2.44 (2.36)	4.98	2.97 (2.89)	4.64	3.16 (3.09)	4.13	2.77 (2.72)	3.92	2.39 (2.34)	3.50	1.78 (1.74)	2.92	1.11 (1.10)	6.99	1.11 (1.10)
1985	120.78	4.02	2.89 (2.76)	3.88	2.10 (2.00)	4.53	2.29 (2.22)	5.28	3.17 (3.09)	4.61	3.13 (3.07)	4.14	2.82 (2.77)	4.00	2.44 (2.40)	3.57	1.82 (1.78)	3.01	1.16 (1.14)	7.27	1.13 (1.12)
1986	121.43	4.00	2.95 (2.81)	3.85	2.10 (2.00)	4.30	2.15 (2.08)	5.59	3.41 (3.32)	4.39	3.02 (2.95)	4.20	2.86 (2.81)	4.07	2.51 (2.46)	3.65	1.82 (1.78)	3.11	1.20 (1.18)	7.55	1.15 (1.14)
1987	122.11	4.06	2.99 (2.86)	3.85	2.19 (2.08)	4.12	2.08 (2.02)	5.48	3.36 (3.27)	4.46	3.05 (2.98)	4.31	2.95 (2.89)	4.11	2.54 (2.49)	3.72	1.89 (1.85)	3.22	1.24 (1.21)	7.90	1.22 (1.22)
1988	122.63	4.18	3.08 (2.95)	3.88	2.26 (2.16)	3.99	2.03 (1.97)	5.17	3.17 (3.10)	4.73	3.22 (3.15)	4.40	3.05 (3.00)	4.12	2.61 (2.57)	3.81	1.94 (1.90)	3.32	1.28 (1.26)	8.21	1.29 (1.28)
1989	123.13	4.28	3.18 (3.06)	3.89	2.32 (2.23)	3.93	2.01 (1.95)	4.81	3.00 (2.94)	4.96	3.41 (3.36)	4.60	3.25 (3.20)	4.08	2.62 (2.58)	3.85	2.01 (1.97)	3.42	1.34 (1.31)	8.52	1.35 (1.34)

*Labor force participation covers both the employed and those who were available for work during the survey week. Includes those seeking jobs and school graduates not yet employed. The figures in parentheses indicate women considered employed, including those who qualify as unpaid family workers and the self-employed as long as they worked one hour in the survey week.

Source: Ministry of Labor, Yearbook of Labor Statistics.

Table 8: Reasons for Termination of Employment by Selected Industries, 1989

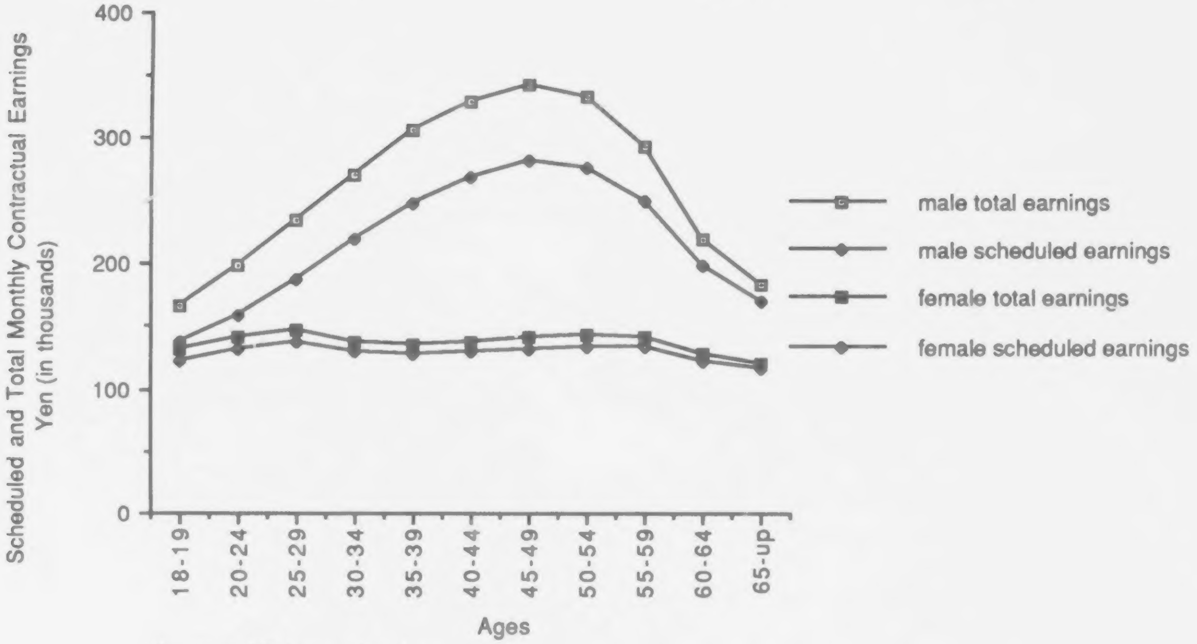
(in thousands)

	Total		Termination of Contract		Employer's Convenience		Temporary Transfer		Rehired by Old Firm		Retirement Age		Own Convenience		Own Responsibility		Marriage/ Children		Sickness/ Injury	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
All Industries	2,026.8	2,364.0	122.7	126.6	194.3	105.2	51.5	6.6	37.8	2.6	131.6	44.5	1,422.6	1,993.6	110.3	55.2	0.9	330.2	45.3	38.8
Manufacturing	708.2	714.3	70.0	29.3	56.4	31.7	16.2	1.8	9.0	1.2	49.5	20.0	479.5	602.2	33.1	16.0	0.5	85.6	19.7	15.1
Wholesale and Retail Trade*	523.5	750.5	11.0	15.8	38.6	27.6	11.5	0.5	12.9	0.5	13.1	8.5	416.9	669.6	37.6	20.0	0.0	112.5	6.3	9.0
Finance and Insurance	40.4	186.9	0.7	2.9	8.1	4.4	4.6	0.2	0.2	0.1	9.0	2.4	20.9	172.7	0.2	0.9	0.0	36.1	1.5	3.6
Real Estate	13.3	12.1	0.1	0.9	2.8	0.3	1.6	0.1	0.5	0.0	1.0	0.2	7.3	8.6	1.9	2.7	0.0	2.9	0.1	0.3
Services	481.1	604.7	24.0	52.6	65.1	37.1	9.7	3.3	12.7	0.7	24.5	11.0	342.3	482.2	14.9	11.9	0.1	79.7	10.3	9.9

*Includes eating and drinking establishments.

Source: Ministry of Labor, Yearbook of Labor Statistics.

Graph 7: Manufacturing Production Workers Earnings by Gender and Age, 1989



Source: Ministry of Labor

recreation industries. Women employed in sales, finance, insurance, educational research and garbage incineration can work an extra day every four weeks. Moreover, a weekly limit of six hours of overtime generally applies for women in manufacturing, with the cap slightly looser (depending on one's interpretation) -- 12 hours over two weeks -- for women not exempt in occupations relating to health and tourism. Finance, sales and similar workers described above have a ceiling of 24 hours of overtime within a four-week period. Other restrictions also apply to pregnant employees; work considered detrimental to their health is banned, for example.

On top of the overtime restrictions is a virtual ban on late-night work, between 10 p.m. and 5 a.m., for most women. Prior to 1986 the Labor Standards Law prohibited almost all women, including professionals and managers, from late-night work. (Exceptions included nurses as well as television and radio announcers.) Critics complained that this prohibition gave employers a good reason not to promote women. Since implementation of the Equal Employment Opportunity Law in 1986, the late-night ban has not applied to female taxi drivers, newspaper deliverers or others where late-night and early-morning work is considered essential. Otherwise, the ban still applies, and it is enforced. Tokyo labor inspectors filed charges in early August against Northwest Airlines after the company's labor union complained that seven women had worked up to four hours beyond the legal limits in a three-month period last year. The labor inspectors also accused the airline of exceeding the 10:30 p.m. limit allowed under a special extension for female employees of airline companies.

This dispute, still under investigation, highlights the role of labor unions in women's employment issues. The groups within company-affiliated labor unions that deal with women's issues have been compared to "social clubs with a correspondingly low status" by author Mary Saso in her book on Japanese women workers.[9] Although Ms. Saso noted that the male-dominated unions presumably have an interest in defending fair pay for women as a way of supporting overall employee compensation, she raises the question of how supportive unions have been on issues where women might challenge men for jobs.

Few Managers - Another reason for broad differences in pay levels between male and female employees is the scarcity of women at the management level. This issue is tied to arguments that fewer women have the continuous employment at a firm that would win them a managerial position under Japan's seniority-based reward structure. But even when women have proved in court that they had worked continuously for a firm and that most of their male cohorts were part of the managerial ranks, they have not always succeeded in gaining legal redress. Ms. Saso refers to a 1987 case in which seven women won agreement from a lower court that they had been discriminated against for promotion; they ultimately lost the case when their employer, a bank, appealed the verdict.[10]

Among the reasons given by employers for not promoting women to management positions are: their tendency to be educated in the humanities rather than more business-related fields; the traditional expectation that women will quit to have a baby or that their family and personal lives are more important to them than the company; the perceived difficulty of scheduling education and training or even rotation to other cities (typical for many large companies) because of a woman's family obligations; and the conventional theory that women are less willing to spend long hours either at work or socializing afterward.[11] Men also have admitted to being hesitant to work for a female boss (see JEI Report No. 18A, May 5, 1989).

Nevertheless, women gradually are moving into management positions (see Table 9). A 1989 Labor Ministry survey found that 6.3 percent of the companies responding had at least one female department head, while 15.9 percent of the respondents had appointed women to be section chiefs. Of all the women employed, however, only 1.2 percent were department heads and just 2.1 percent section chiefs. The survey further noted that about 60 percent of those attaining at least section chief status had never married and 72 percent had been employed continuously by the company.[12]

A private 1989 survey noted that in many respects Japanese women did not necessarily conform to stereotypes about achieving management-level positions. Whereas 22.5 percent of Americans and 19.5 percent of the British women answering the poll said they expected such success by staying in one company, only 9.1 percent of the Japanese respondents did. The experience gained by working for several companies was the pathway to a management job anticipated by 7.2 percent of the American respondents, 3.1 percent of the Japanese and 2.9 percent of the British. Gaining "expert" status in one company seemed the best

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[9] Saso, op. cit., p. 76.

[10] Saso, op. cit., p. 72.

[11] Japanese Women Yesterday and Today, op. cit., pp. 17-18.

[12] Japanese Women Yesterday and Today, op. cit., p. 18.

Table 9: Employment by Gender and Occupation, 1983-89*

(in thousands)

	Professional/ Technical		Managers/ Officials		Clerical Workers		Sales Workers		Farm, Fishery/ Forestry Workers	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
1983	2,660	2,320	2,020	130	4,540	5,440	5,410	3,280	2,690	2,520
1984	2,870	2,400	2,000	130	4,600	5,610	5,440	3,260	2,610	2,440
1985	2,930	2,450	1,970	140	4,530	5,680	5,370	3,240	2,610	2,410
1986	2,940	2,500	1,970	160	4,460	5,860	5,510	3,310	2,560	2,330
1987	3,450	2,630	2,060	170	4,370	5,950	5,640	3,440	2,540	2,300
1988	3,620	2,700	2,110	170	4,440	6,210	5,880	3,530	2,460	2,230
1989	3,850	2,810	2,160	190	4,490	6,530	5,710	3,560	2,410	2,170

*Annual figures are averages for the year.

Source: Ministry of Labor, Yearbook of Labor Statistics.

method for 21.4 percent of the Americans in the poll, 18.1 percent of the Japanese and 16.9 percent of the British. More British respondents (8.8 percent) saw the possibility for success by being an expert at many companies, whereas 7.9 percent of the Japanese respondents and 6.2 percent of the Americans polled favored this method. Entrepreneurial action topped the list for Americans at 24.7 percent, while 17.3 percent of the British and 13.3 percent of the Japanese respondents agreed that this was the way to win a management position. Most Japanese surveyed (49.5 percent) named "other," which the pollster said possibly indicated that the respondents had no specific career outlook; this choice attracted 23.5 percent of the British and 17.9 percent of the Americans.[13]

Given the importance in Japan of preserving family stability and the presumption that women are predominantly responsible for making sure home life runs smoothly, working women who want pay equity and advancement opportunities have to make hard choices concerning careers and family. These choices may be no different than elsewhere in the industrialized world. In Japan, however, various programs and laws, including the 1985 Equal Employment Opportunity Law, often put these choices in a different framework.

Good Intentions

Equal Employment Opportunity Law - Past discriminatory practices in gender-based job advertisements, hiring, assignments and promotions were forbidden under the Equal Employment Opportunity Law; complaints were to be mediated or submitted to arbitration committees. The law, however, laid out no sanctions for violations. Now that the law has been in effect for five years,

[13] Foundation of Professional Women, Working Women Fact Book (Tokyo: Toyo Keizai Shinposha, 1991) (in Japanese).

some results are becoming evident. One considered possibly deleterious to women's interests is that some companies have began to require female employees to make a choice at the time they are hired of whether they prefer a career on the sogo shoku (general management) track or a job on the ippan shoku (clerical) track. In this way the company presumably can treat female workers the same way they do men, who are assumed to be sogo shoku employees. Alice Lam, a management development fellow at England's Manchester University Business School, has questioned the application of the two-track system, saying, "[I]n practice men are almost automatically assigned to [the career management track], whereas women are selected for it only exceptionally. During selection interviews, women often appeared to be challenged with tough questions about mobility and potential sacrifices of family life. Despite the formal offer of opportunities, in reality very few women managed to pass the selection procedures."[14]

Possibly as a result of the decisions forced on them by the EEO law, more women interviewed in 1984 said they planned to follow a continuous career path than did women in 1988, when increased numbers said they planned to quit work to have children.[15] Women's response to the opportunity to join the management track has not been enthusiastic; nor have all recruits stayed aboard, according to a freelance writer for the American Chamber of Commerce in Japan Journal. Doune Porter noted that many women who initially signed on to the sogo shoku track later have chosen to switch to the clerical track.[16]

Some companies have recognized that an early vote by women to "go management" poses tough questions about future commitments to the company -- especially the chance of a transfer at a time when a woman might be interested in starting a family; these employers have sketched a management-track possibility for women that does not require transfers.[17] How well plans like these will work remains to be seen. Responses to a 1989 MOL survey indicated that roughly 40 percent of the biggest corporations in Japan had adopted a multiple-track personnel system of some kind, while only about 22 percent of the next-largest firms (between 1,000 and 5,000 employees) had such a plan. Most companies said they did not expect to introduce such an option.

Government Not Necessarily a Model - Ostensibly the central government's hiring is gender-blind both because of the EEO law and because professional positions are obtained through examination. Yet only 199 women were among the applicants who successfully passed this year's test; they represented 9.9 percent of the total. Placements obtained by those with just a senior high school education numbered 191 women versus 619 men in 1989. The fact that the central government's work force is only 17.5 percent female simply may mean that few women choose to take the government exam or apply for a government job; the equality presumed in government jobs is likely to mean long hours at lower pay than entrants might earn in the private sector. It could be symptomatic of a broader problem, however, given the low ratio of women to men in jobs requiring less education.

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[14] Alice Lam, "Equal Employment Opportunities for Japanese Women," Anglo Japanese Journal, V, No. 1, May-August 1991, p. 22.

[15] Ibid.

[16] Doune Porter, "The Glass Ceiling: Japanese Women and Upward Mobility," American Chamber of Commerce in Japan Journal, May 1991, p. 27.

[17] Ibid.

Political women have had a higher profile than their bureaucratic counterparts, especially after 1986 when the Japan Socialist Party appointed Takako Doi as its chairperson. Ms. Doi, who resigned earlier this summer, was credited with boosting the number of women in the upper house of the Diet in a 1989 campaign that featured "madonna candidates" as a protest of what was called a corruption-prone, male-dominated political system (see JEI Report No. 32A, August 18, 1989).

Among several relatively recent political firsts have been the first woman appointed chief cabinet secretary, Mayumi Moriyama in 1989; the first Japanese woman to be named as a high official in an international organization, Sadako Ogata as the United Nations High Commissioner for Refugees in 1990; and, at the local level, the first woman to become a vice governor. This past May Teruko Kanehira, former director of the Tokyo Metropolitan Government's Social Welfare Department, became Tokyo's vice governor, two months before the Okinawa prefectural assembly approved a female candidate for its vice governor. Women still lag behind men in local politics, though, accounting for roughly 2 percent of all prefectural assembly members and 4 percent of city assemblies in 1989.

The central government is susceptible to criticism not just for the relatively low percentage of women on its payroll but also for its failure to meet a self-imposed goal to boost women's participation on government-appointed advisory councils to at least 10 percent by fiscal 1991. Of the 200-plus councils advising cabinet ministers at the end of March 1991, women comprised 9 percent of the participants, holding 398 of the 4,434 seats, according to a survey reported in July by Kyodo News Service. The director of the government's women's affairs office was quoted as saying, "In order to attain real equality between men and women, women have to have power in decisionmaking." Officials in Japan have set a goal of only 15 percent participation by women on such committees for 1995, half that recommended by the United Nations at whose urging Japan originally set the participation goals. Although women are well-represented on panels directly related to women's issues, few are appointed to science or technology committees; interestingly, the only cabinet position now held by a woman is that of the Science and Technology Agency. Since the private sector suggests names for appointments, the women's affairs office has asked the government to urge more consideration of women as nominees.

<ins>Child Care Leave Law</ins> - A carefully worded, nongender-based Child Care Leave Law won Diet approval this year and will go into effect next April. Companies are urged to arrange a system whereby either parent can take time away from work until an infant is a year old. Between April 1992 and March 1995 the law will apply only to firms with 30 or more employees, meaning that for three years about 33 percent of the female work force employed in manufacturing will not be affected; nor will 44 percent of the women working in the wholesale and retail sector and 35 percent of those in the services sector. Neither will fathers working in such firms be eligible for leave. After April 1995, however, small firms are expected to comply. Even those to whom the law will apply initially have no guarantee that they will be paid if they are allowed leave. Moreover, they have no recourse for noncompliance since the law contains no

penalties. Keizai Doyukai (Japan Association of Corporate Executives) had opposed any sanctions being included in the law, which opposition parties had urged; under a compromise the possibility of drafting sanctions will be considered at a later date.

The legislation suggests that firms present to the Labor Ministry their plan -- including how wages and reentry into the company will be handled -- so that the government can offer advice. The Labor Standards Law currently sets out provisions under which pregnant employees can receive six weeks of leave before childbirth and up to eight weeks after delivery, with six of those post-delivery weeks required to be offered as leave. Pregnant women or new mothers taking advantage of these leave provisions cannot be fired in the meantime or for 30 days after the period of leave. Although the Equal Employment Opportunity Law obligated employers to set out how they would implement these provisions, only 16.6 percent had done so by February 1989.[18] (Even if a company does not grant partial or full pay during pregnancy or maternity leave, the Health Insurance Law provides for up to 60 percent of the affected employee's daily wage during the period.)

Several companies, particularly those with a large proportion of highly trained female employees, have instituted more generous leave policies; some guarantee that the jobs of employees on child care leave will be available for up to three years. As many as 19.2 percent of all companies with 30 or more employees have instituted some form of child care leave, according to the Japan Institute of Women's Employment. Moreover, the Labor Ministry has suggested compensating firms that implement such provisions; when the leave law was passed in May, the proposed compensation figure was Y200,000 ($1,500) per employee who took child care leave.

The difficulty women have had in the past reentering the work force after leaving for a period is said to be one of the reasons more of them are expected to take advantage of the new leave policies and return to work more quickly than they might have previously. Such a result would reinforce the government's twin goals of encouraging more women to work as well as encouraging women to have more babies (who, in turn, will support current generations in their old age).

Day-Care Centers - The government's recognition of women's interest in working and its concern about the low birth rate coincide in its decision to push the availability of day-care centers. Surveys indicate that about 90 percent of all children under the age of 2 stay at home with a caregiver, but by age 5 almost one-third are in day-care centers; 63.7 percent in 1987 attended kindergarten. Although a majority of both men and women prefer that someone be at home with a young child, a 1988 Ministry of Health and Welfare survey showed that more of the younger generation believed day-care centers should be improved to enable women to continue working. In the 20-29 age bracket 20.4 percent of the female and 18.2 percent of the male respondents favored day-care improvements that allow mothers to remain on the job. The idea that parental leave systems should be improved so that one parent can stay at home while a child is young but return to work later drew 36.4 percent backing from the men in that age group; slightly more (39.1 percent) supported the traditional concept that one parent should stay at home with a child. Better leave policies were a strong favorite of the female respondents in the 20-29 group; 51 percent picked that option compared to the 24.3 percent preferring that one parent stay at home. The traditional view gained support among older age groups for both men and women; favoring that response were 38.3 percent of the women and 46 percent of the men in the 50-59 age group.

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[18] Japan's Working Women Today, op. cit., p. 27.

Despite traditional views, more mothers are working. An estimated 68.6 percent of those who gave birth in 1988 continued to work compared with a 50.9 percent rate in 1965, according to government figures. Not all these mothers rely on day-care centers. The 1988 data showed that 67.2 percent of working mothers with a baby less than a year old left the infant with their parents or parents-in-law. The extent of three-generation households in Japan, 13.5 percent of the total in 1990, has declined gradually. The availability of a caregiver at home is one reason an estimated 67.4 percent of mothers in three-generation families work compared with 49.3 percent of mothers in nuclear families.

The aging of Japan's population also has put working women in three-generation households on notice that they may be called home to care for an older relative as easily as for a sick child. The government's response has been to try to boost not only the number of children's day-care centers but those for the elderly as well. MHW subsidized 1,080 elderly day-care facilities in its FY 1989 budget; another 129,600 facilities were available as "clubs."

In 1989 public day-care centers for children numbered 13,449; registered private facilities totaled 9,237. The vacancy rate was about 13 percent. Problems include a shortage of centers that accept infants (about 22 percent do) and a scarcity of facilities staying open until at least 7 p.m. (only about 9 percent do). As of April this year the Ministry of Health and Welfare set a 7 a.m. to 10 p.m. schedule for at least 200 public centers. MHW also has said subsidies would be available in late 1991 for child-care centers that have signed contracts with various companies that require late-night and weekend hours. One response by day-care firms in Japan has been to tie up with U.S. companies experienced in setting up in-house day-care services at corporate sites.

Attitudes and the Potential for Change

The perception of women workers in Japan is that they see employment as a choice rather than a matter of course. Reinforcing this idea, the media pay little attention to women who must support themselves and feature, instead, the so-called Office Ladies who live with their parents and are portrayed widely as approaching work somewhat frivolously since they expect to quit when they marry; until then they spend their income on designer clothes and travel. This latter group, determined strictly by age-based participation and ignoring the many women under the age of 35 who are serious about careers, represents at most about one-third of the women in Japan's labor force.

What of the women who intend to pursue a career? Reports show that jobs with an aura of glamor top the list. A recent survey by a private job placement firm of women graduates of four- or two-year colleges indicated that preferred employers were airlines and travel agencies. According to the survey, insurance firms ranked high but financial institutions -- tainted by scandal -- had lost their appeal. Firms associated with electronics advanced in the eyes of female university graduates. The number of women who study to become medical doctors has risen steadily, but women still make up only about 11 percent of all medical doctors. Similarly, women who have been accepted into the Legal Training and Research Institute, which qualifies lawyers, have accounted for between 2 and 2.2 percent of all entrants over the last six years. Of women who enter the teaching profession the majority are elementary school teachers; less than 20 percent become university professors.

In general, women study far more liberal arts subjects than men and are less interested in the social sciences or engineering. As noted above, employers weigh an applicant's educational background as evidence of an interest in a career. Whether women will begin to study more business-oriented subjects could depend on their employment expectations.

Despite support from the government in the form of day-care centers and child care leave, societal attitudes remain strong among both men and women that mothers should stay at home with young children. Most companies appear less than committed to implementing leave laws and reentry provisions that would allow a parent to take a leave of absence to spend time at home in a child's early years. Several observers of the Japanese work scene have suggested that the key to improving women's status in the work world without shortchanging the needs of the family is to encourage shorter working hours for everyone. The burden put on working women, who are responsible for most household and child care duties, will not be lifted until men begin to share some of these duties, these analysts say. Former head of the Economic Planning Agency, Sumiko Takahara, recently outlined her recipe for major structural change:

> In order to reduce working hours and bring greater real affluence and comfort to Japanese society, we will need still more women in the work force. When this happens, men will be required to participate more in the household, using the free time they gain through the reduction in working hours.

Ms. Takahara added, "Shorter work hours for all could reduce complaints by foreign critics who feel the Japanese work too much.[19] Although the government has set a goal of reducing the average number of hours worked a year to 1,800 by 1992, few labor analysts expect the actual figure to drop that speedily from FY 1990's average of 2,044 hours. Recorded overtime in FY 1990 worked out to about 185 hours per regular employee, but that figure does not include the time "freely" contributed by employees who "clock out" of the building but continue to work. Expectations of overtime clash with both a company's willingness to promote working mothers and working mothers' enthusiasm for staying on the job. Overtime demands are an even greater concern if day-care centers close earlier than one of the parents can leave work.

Another problem for working mothers in Japan is the expectation by most employers that employees will take only part of their annual leave. In her book

[19] Sumiko Takahara, "Women Power in Japan's Economy," Journal of Japanese Trade & Industry, No. 2, 1991, p. 30.

on Japanese working women Ms. Saso noted that not all women were happy when the Labor Ministry revised annual leave laws in 1988 to encourage more use of vacation time through standardized leave schedules. Working mothers "who save most of their leave to be used at the times when they need to care for sick children or to attend school meetings" greeted the plan with dismay, she wrote.[20] Although American mothers may use their leave for much the same reasons, the constraints on taking leave generally are fewer.

The government's effort to shorten the work day is only one change that could affect the male-oriented work world in Japan. As already pointed out, the labor shortage could result in more women taking regular, full-time jobs. Similarly, more men might be attracted to part-time and temporary positions; demand for part-time employees also may lead to rising pay scales. Other changes might be on the horizon for the seniority system. The Labor Ministry reported in July, for example, that one of every 10 companies this year offered new recruits starting salaries higher than those given current employees. The seniority system long has played a major role in determining wages, although companies have found ways to give merit pay or to hire midcareer recruits at attractive salaries dissociated from seniority concerns. Changes in the seniority system could have an impact on female workers who gain skills early in their work history but take time out to have children. A less rigid system also might allow more leeway for women who seek management positions, not only because the tradition remains that women are the most likely to take time off for child care but because employers, themselves, might start giving more weight to merit than longevity in deciding promotion potential.

As more and more Japanese women enter the work force, their own attitudes toward working will play a key role in their chances of being viewed as an integral part of the labor force and not just a supplement. Recognizing the need for changes in societal attitudes, the women's liberation movement in Japan in the 1970s concentrated on changes in society as a whole and not necessarily on job equality.[21] Japanese women's groups still do not focus strictly on employment equality as much as on a broad array of issues concerning women, including health and safety. Nihon Fujin Dantai Rengokai (Federation of Japanese Women's Associations), an umbrella organization representing 19 individual women's groups with 700,000 members, works not only on equal rights but the abolition of nuclear weapons, for example. The Japan Association of Female Executives lends practical support to its members by recruiting a pool of college students as babysitters to enable members to attend seminars or to work late. The group's advice sessions include child-raising strategies.[22]

Concerns Overseas

The increase in Japanese-owned subsidiaries overseas has generated an interest in whether personnel patterns are following the spiritual lead of the home office more than the letter of the law of the country in which the subsidiary is based. Japanese businesses operating overseas are required to meet wage, hiring and other nondiscriminatory personnel practices as defined by national and local laws. Concern that foreign-based firms are skirting such requirements in the United States is behind three hearings before the House Committee on Government Operations' subcommittee on employment and housing, chaired by Rep. Tom Lantos. At the first hearing in July (another was held in August and the third is planned for September) the chairman of the U.S. Equal Employment Opportunity Commission noted that the call to testify before the California Democrat's subcommittee was "the first time we have been asked [in the agency's 26-year history] to compare the 'track record' of foreign corporations to domestic corporations." Evan Kemp, Jr. also cautioned that comparisons could raise questions that "entangle civil rights with foreign policy considerations."[23]

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[20] Saso, op. cit., p. 111.

[21] See Yumiko Ehara, Body of Thought Known as Women's Liberation (Tokyo: Keisou Shobou, 1985) (in Japanese) or an English annotation included in Introductory Bibliography for Japanese Studies, VI, Part I: Social Sciences, 1981-1985 (Tokyo: Bonjinsha Co., Ltd.)

[22] Saso, op. cit., p. 119.

After giving caveats about the use of comparisons, Mr. Kemp noted that EEOC's information found that, based on the 39 Japanese-owned firms reviewed along with other companies filing specific EEO forms: "Women gained one-third of all new jobs in Japanese-owned companies during the 1980-1985 period and 38 out of every 100 new jobs during the 1985-1989 period." This compared, Mr. Kemp said, with other foreign-owned companies' experience of hiring women for about three-fourths of all their new jobs between 1980 and 1985. He added that in 1989, "The representation of women was lowest in Japanese-owned companies, 38.5 percent compared to 49 percent in other foreign-owned companies and 46.2 percent in total companies. . . . Women were 15.9 percent of the officials and managers in Japanese companies compared to 32.3 percent in other foreign-owned companies and 28.6 percent in all companies."

Yet Japanese firms in the United States have made advances in hiring women, Mr. Kemp told the subcommittee. Female employment grew 18.4 percent a year at Japanese-owned companies over the 1985-89 period but only 3.3 percent at other foreign-owned firms and 4.1 percent for all firms used in the comparison. Similarly, he said, a higher percentage of women managers was appointed between 1985 and 1989 at Japanese-owned firms here (27.5 percent a year) than at the average firm (18.4 percent a year). The advances might stem from charges or the threat of charges against Japanese-affiliated companies; 115 EEO complaints were filed in 1990 against 35 Japanese-owned firms, a number Mr. Kemp termed small compared with the total of 59,426 complaints filed last year. Or Japanese-owned firms might have seen the writing on the wall from a 1987 Supreme Court decision that essentially declared that the American subsidiaries of foreign-owned firms had to meet U.S. laws.

In some cases women in the United States may have better prospects for employment by Japanese-owned companies than Japanese women would at home. Given U.S. enforcement of equal employment opportunities, women have more chances to challenge stereotypes by working on the assembly floor at automotive factories, for example. Toyota Motor Corp.'s August announcement that it would raise the number of women employed on its production lines in Japan from 90 to 500 over the next five years (out of overall employment of about 68,000) contrasts with its U.S. employment record. At Toyota's Georgetown, Kentucky plant

[23] Written statement of Evan Kemp, Jr. before House Committee on Government Operations, Subcommittee on Employment and Housing, July 23, 1991.

the 3,900-person work force is 25 percent female, while Toyota's joint operation with General Motors Corp. in Fremont, California employs nearly 500 women on its 2,700-person production staff. Similarly, Nissan Motor Co., Ltd., which has 560 females working on its assembly line in Japan (out of a total of 55,000 employees), also employs a higher percentage of women at its U.S. plant; of the 3,098 technicians in Smyrna, Tennessee, 671 are women.

Yet in terms of legislated child care leave and state-subsidized day-care centers, the average working mother (and father) appears to receive a degree of direct government support in Japan that is not as overt in the United States. Laws alone, however, are not sufficient for assuring equality in employment in any country. Although a change in corporate and societal attitudes may accompany increased education and internationalization, companies in Japan probably will continue to push aside the concerns of working parents in favor of the benefits to the bottom line of a solid core labor force that works long hours. While women are making some inroads into that core group, many still are forced to make a choice between work and family. Even those who do not face this choice find that protective laws and attitudes prevent them from equal employment opportunities. In short, the prospect for real advances remain slim until both men and women begin to recognize that women are more than a supplemental source of labor in Japan.

For further information, contact Pat Murdo.

Loren Edelson provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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NOTE

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1, Statistical Supplement

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JAPAN · ECONOMIC · INSTITUTE

JEI

REPORT

A Two-Part Report: A and B

NO. 33B
August 30, 1991

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Tokyo Supports Soviet Independence Movement . . . Cautiously

A little more than a year after Iraq invaded Kuwait Tokyo again faced an international crisis against which Japan's willingness to assume global leadership responsibility was measured. The August 19 attempted coup d'etat by Soviet communist hard-liners and its collapse three days later afforded the Japanese government an opportunity to rectify the country's image of a reactive, self-centered power -- an image, some critics say, that Japan began to develop with the 1979 American hostage crisis in Iran and which it failed to shake with its too little, too late handling of the more recent Middle East conflict. In the latest crisis most international commentators credit Japan with quickly closing ranks with its Western allies by suspending economic assistance to the Soviet Union and questioning the legality of the uprising.

Prime Minister Toshiki Kaifu's hesitancy about condemning outright the seizure of power by the eight-member State Committee for the State of Emergency drew fire within Japan, however, as the response of a "small country" that is not a significant player on the world stage. While some of this criticism had political motivations -- its chief sources were contenders for Mr. Kaifu's job -- the spate of editorials and media attacks on the Japanese government's

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1989	1990	January-June 1990	January-June 1991	April 1991	May 1991	June 1991
Japan's Balance of Payments							
Trade Balance	$76,917	$63,528	$28,007	$43,723*	$8,226*	$5,486*	$9,282*
Exports (f.o.b.)	269,570	280,374	130,970	146,921*	23,423*	23,752*	24,768*
Imports (f.o.b.)	192,653	216,846	102,963	103,198*	15,197*	18,266*	15,486*
Current Account Balance	57,157	35,761	20,197	28,931*	7,772*	4,274*	6,625*
Long-Term Capital (net)	-89,246	-43,586	-35,071	3,776*	1,091*	-7,689*	-333*
Overall Balance	-33,286	-7,234	-8,003	7,444	-784	-939	1,038
International Reserves (end of period)	84,895	77,053	73,649	67,892	67,935	68,168	67,892
Japan's Customs Clearance Trade							
Trade Balance	64,328	52,149	25,599	32,314	6,324	4,184	7,242
Exports (f.o.b.)	275,175	286,948	133,936	150,387	24,110	24,463	25,431
Cars	38,804	41,348	19,759	21,450	3,258	3,116	3,276
Steel	14,789	12,509	5,882	6,645	1,113	1,196	1,144
Imports (c.i.f.)	210,847	234,799	108,337	118,073	17,786	20,279	18,189
Crude Oil	21,544	31,584	12,375	15,438	957	1,985	1,901
Manufactured Products	106,111	118,028	55,180	59,033	9,919	10,403	9,283
Japan-U.S. Trade							
Trade Balance	44,943	37,954	16,985	15,940	2,271	1,943	2,649
Exports (f.o.b.)	93,189	90,322	42,599	42,633	6,500	6,760	7,049
Imports (c.i.f.)	48,246	52,369	25,614	26,694	4,229	4,817	4,401
Yen-Dollar Exchange Rate (average for period)	Y137.96	Y144.79	Y151.58	Y136.08	Y137.10	Y138.00	Y139.79
U.S. Trade							
Trade Balance	-109,399	-101,718	-42,469	-24,709*	-3,419	-3,986	-4,081*
Exports (f.a.s.)	363,812	393,592	198,223	210,326*	36,110	36,136	35,450*
Imports (Customs)	473,211	495,311	240,691	235,035*	39,529	40,121	39,531*
U.S.-Japan Trade							
Trade Balance	-49,059	-41,105	-19,710	-19,206*	-3,348	-2,432	-3,231*
Exports (f.a.s.)	44,494	48,580	23,499	24,446*	3,908	4,256	3,959*
Imports (Customs)	93,553	89,684	43,209	43,652*	7,256	6,688	7,190*

*Preliminary

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1989	1990	January-June 1990	January-June 1991	April 1991	May 1991	June 1991
Discount Rate (end of period)	4.25%	6.0%	5.25%	6.0%	6.0%	6.0%	6.0%
Outstanding Money Supply	9.9%	11.7%	12.3%	4.9%*	3.8%	3.6%	3.7%*
Industrial Production	6.1%	4.6%	2.6%	4.4%	3.8%	4.3%	1.1%
Manufacturing Operating Rate	2.2%	2.3%	0.8%	0.7%	0.7%	0.3%	-2.8%
Number of Bankruptcies	-28.5%	-10.6%	-25.5%	60.2%	58.9%	77.8%	74.8%
Residential Construction Starts	-1.3%	2.7%	4.3%	-16.7%	-18.9%	-22.1%	-21.6%
Job Openings to Applications (ratio)	1.26	1.40	1.38	1.45	1.46	1.44	1.43
Nominal Wages	4.1%	4.7%	4.7%	3.6%	3.9%	3.9%	3.7%
Manufacturing Labor Productivity	6.2%	4.2%	2.2%**	6.1%**	n.a.	n.a.	n.a.
Wholesale Prices	2.5%	2.0%	2.7%	1.0%	0.1%	0.6%	0.6%
Consumer Prices	2.3%	3.1%	2.9%	3.8%	3.7%	3.4%	3.6%
Yen-Based Export Prices	4.4%	2.1%	6.0%	-4.9%	-7.1%	-5.2%	-4.6%
Yen-Based Import Prices	7.7%	8.6%	10.2%	-3.4%	-9.4%	-7.8%	-6.0%

*Preliminary.
**Through March of each year only.

For Japan's latest GNP figures, see JEI Report No. 24B, June 28, 1991.

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JAPAN · ECONOMIC · INSTITUTE

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REPORT

A Two-Part Report: A and B

NO. 34A September 13, 1991

STATISTICAL PROFILE

JAPAN'S ECONOMY IN 1990
AND
INTERNATIONAL TRANSACTIONS OF JAPAN AND THE UNITED STATES IN 1990

Japan Economic Institute 1000 Connecticut Avenue, N.W., Washington, D.C. 20036 202·296·5633

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Table 1: Japan's Gross National Product at 1985 Constant Prices, 1986-1990

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	1986	1987	1988	1989	1990
Gross National Product	Y330,021.6 (2.6%)	Y344,332.7 (4.3%)	Y365,823.4 (6.2%)	Y383,092.8 (4.7%)	Y404,654.6 (5.6%)
Personal Consumption Spending	195,078.9 (3.4%)	203,335.9 (4.2%)	213,983.1 (5.2%)	223,296.8 (4.4%)	232,235.3 (4.0%)
Private Residential Construction	15,777.9 (7.8%)	19,348.6 (22.6%)	21,643.9 (11.9%)	21,661.4 (0.1%)	23,581.4 (8.9%)
Private Fixed Nonresidential Investment	54,047.3 (4.4%)	57,653.7 (6.7%)	66,167.1 (14.8%)	76,512.9 (15.6%)	87,125.1 (13.9%)
Change in Business Inventories	1,197.3 (-34.3%)	824.9 (-31.1%)	3,218.5 (290.2%)	3,684.3 (14.5%)	2,939.9 (-20.2%)
Government Current Expenditures	31,986.4 (4.5%)	32,124.0 (0.4%)	32,815.3 (2.2%)	33,510.3 (2.1%)	33,983.0 (1.4%)
Government Fixed Investment	22,445.6 (3.6%)	24,091.4 (7.3%)	25,335.7 (5.2%)	25,042.5 (-1.2%)	25,920.7 (3.5%)
Change in Government Inventories	582.9 (*)	50.8 (*)	-239.7 (*)	-87.6 (*)	128.2 (*)
Net External Sector	8,905.3 (-25.6%)	6,903.4 (-22.5%)	2,899.5 (-58.0%)	-527.8 (*)	-1,259.1 (*)
Exports of Goods and Services and Factor Income Received	49,399.9 (-5.4%)	51,668.2 (4.6%)	57,212.6 (10.7%)	65,779.2 (15.0%)	72,943.4 (10.9%)
Imports of Goods and Services and Factor Income Paid	40,494.7 (0.6%)	44,764.8 (10.5%)	54,313.1 (21.3%)	66,307.0 (22.1%)	74,202.4 (11.9%)

(continued)

Table 1: Japan's Gross National Product at 1985 Constant Prices, 1986-1990 (continued)

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	January-March 1989	April-June 1989	July-September 1989	October-December 1989	January-March 1990	April-June 1990	July-September 1990	October-December 1990
Gross National Product	Y376,977.2 (4.2%)	Y376,976.7 (-0.0%)	Y386,060.6 (10.0%)	Y391,148.0 (5.4%)	Y397,447.8 (6.6%)	Y402,877.4 (5.6%)	Y407,432.8 (4.6%)	Y410,021.2 (2.6%)
Personal Consumption Spending	220,310.2 (6.0%)	219,177.7 (-2.0%)	224,266.3 (9.6%)	228,740.9 (8.2%)	229,493.1 (1.3%)	233,094.6 (6.4%)	233,453.1 (0.6%)	232,841.7 (-1.0%)
Private Residential Construction	21,883.5 (-0.8%)	21,399.5 (-8.6%)	21,598.2 (3.8%)	21,785.9 (3.5%)	22,080.3 (5.5%)	23,238.8 (22.7%)	24,616.2 (25.9%)	24,218.7 (-6.3%)
Private Fixed Nonresidential Investment	73,931.1 (25.6%)	73,416.3 (-2.8%)	77,616.2 (24.9%)	80,529.8 (15.9%)	83,429.0 (15.2%)	85,923.6 (12.5%)	87,867.2 (9.4%)	90,949.6 (14.8%)
Change in Business Inventories	2,348.7 (*)	4,571.4 (*)	3,799.5 (*)	3,961.4 (*)	2,180.7 (*)	3,348.8 (*)	3,512.8 (*)	2,710.5 (*)
Government Current Expenditures	33,358.4 (3.5%)	33,586.6 (2.8%)	33,452.8 (-1.6%)	33,646.9 (2.3%)	33,901.9 (3.1%)	33,902.0 (0.0%)	33,945.9 (0.5%)	34,185.3 (2.9%)
Government Fixed Investment	24,827.0 (-2.2%)	25,097.3 (4.4%)	24,968.8 (-2.0%)	25,294.9 (5.3%)	25,697.3 (6.5%)	25,958.5 (4.1%)	26,018.8 (0.9%)	26,046.1 (0.4%)
Change in Government Inventories	130.5 (*)	293.8 (*)	-20.4 (*)	-721.0 (*)	203.4 (*)	433.5 (*)	603.0 (*)	-724.7 (*)
Net External Sector	187.8 (*)	-566.0 (*)	379.1 (*)	-2,090.8 (*)	462.1 (*)	-3,022.4 (*)	-2,584.2 (*)	-206.0 (*)
Exports of Goods and Services and Factor Income Received	62,742.3 (18.4%)	64,673.5 (12.9%)	66,903.6 (14.5%)	68,977.2 (13.0%)	73,636.7 (29.9%)	74,052.7 (2.3%)	70,837.4 (-16.3%)	73,259.1 (14.4%)
Imports of Goods and Services and Factor Income Paid	62,554.5 (45.0%)	65,239.5 (18.3%)	66,524.5 (8.1%)	71,068.0 (30.2%)	73,174.6 (12.4%)	77,075.1 (23.1%)	73,421.6 (-17.6%)	73,465.1 (0.2%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

Table 2: Major Interest Rates in Japan, 1986-1990

(percent per annum)

	Central Bank Discount Rate*	Long-Term Prime Lending Rate*	Call Rate**	Average Interest Rate on Loans and Discounts of All Banks*	Savings Deposits*: Commercial Banks: Ordinary Deposits	Savings Deposits*: Commercial Banks: Six-Month Time Deposits	Savings Deposits*: Post Office: Ordinary Deposits	Savings Deposits*: Post Office: One-Year Savings Certificates	Average Interest Rate on Certificates of Deposit*
1986	3.0%	6.2%	4.79%	5.51%	0.26%	3.01%	1.68%	2.26%	4.56%
1987	2.5	5.7	3.51	4.94	0.26	2.64	1.68	2.26	4.53
1988	2.5	5.7	3.62	4.93	0.26	2.64	1.68	2.26	4.48
1989	4.25	6.5	4.87	5.78	0.50	3.57	1.92	2.82	6.65
1990	6.0	8.1	7.24	7.70	2.08	5.33	3.48	4.58	8.28

*End of period.
**Average for period.

Source: Bank of Japan

Table 3: Money Supply in Japan, 1986-1990

(in billions of yen, average for period)

	Outstanding Money Supply (M2+CDs)*	Change
1986	¥320,732	8.7%
1987	354,036	10.4
1988	393,667	11.2
1989	432,671	9.9
1990	483,119	11.7

*Includes currency in circulation, demand deposits and time deposits (excluding trust accounts) held by commercial banks, plus certificates of deposit.

Source: Bank of Japan

Table 4: Japan's General Account Expenditures (Revised), FY 1986-FY 1990*

(in billions of yen and percent change)

	FY 1986		FY 1987		FY 1988		FY 1989		FY 1990	
Total Expenditures	Y53,824.8	1.1%	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%
Social Security	10,090.3	2.6	10,321.8	2.3	11,801.4	14.3	12,474.2	5.7	11,544.6	-7.5
Public Assistance	1,110.4	2.6	1,105.2	-0.5	1,062.0	-3.9	1,080.6	1.8	1,050.8	-2.8
Social Welfare	1,977.8	-3.8	2,033.2	2.8	2,146.3	5.6	2,307.7	7.5	2,446.8	6.0
Social Insurance	6,137.3	5.0	6,310.2	2.8	7,732.3	22.5	8,206.4	6.1	7,204.8	-12.2
Health Services	497.2	7.1	512.3	3.0	500.7	-2.3	525.4	4.9	561.8	6.9
Unemployment Compensation	367.6	-2.4	361.0	-1.8	360.2	-1.2	354.1	-1.7	280.5	-20.8
Education and Science	4,886.6	-0.4	5,063.7	3.6	4,982.0	-1.6	5,075.3	1.9	5,359.4	5.6
Compulsory Education	2,414.9	-0.0	2,392.9	-0.9	2,463.5	3.0	2,475.5	0.5	2,642.6	6.7
Transfer to School Account	1,083.7	0.8	1,180.1	8.9	1,124.4	-4.7	1,184.8	5.4	1,264.3	6.7
Science and Technology Promotion	381.8	1.7	473.5	24.0	426.6	-9.9	453.9	6.4	474.2	4.5
School Facilities	350.0	-9.2	354.6	1.3	283.3	-20.1	262.7	-7.3	244.3	-7.0
School Aid	575.7	1.1	580.9	0.9	601.0	3.5	615.4	2.4	650.3	5.7
Student Loans	80.5	-3.7	81.7	1.5	83.3	2.0	83.0	-0.4	83.7	0.9
Public Works	6,946.3	0.3	7,428.0	6.9	6,683.0	-10.0	7,398.9	10.7	7,013.2	-5.2
Erosion and Flood Control	1,101.4	1.7	1,221.9	10.9	1,059.4	-13.3	1,080.3	2.0	1,087.3	0.6
Road Improvement	1,826.3	-1.6	1,983.8	8.6	1,744.1	-12.1	1,782.3	2.2	1,789.2	0.4
Harbors and Airports	517.3	1.1	563.7	9.0	497.1	-12.8	511.5	2.9	515.0	0.7
Housing	940.2	1.3	964.4	2.6	930.3	-3.5	1,539.2	65.5	930.9	-39.5
Social Infrastructure	989.0	1.9	1,106.1	11.8	942.6	-14.8	954.8	1.3	957.4	0.3
Agricultural Infrastructure	886.9	0.9	963.7	8.7	852.4	-11.5	867.8	1.8	870.4	0.3
Forestry and Industrial Water Supplies	170.4	0.5	181.2	6.3	163.0	-10.0	160.2	-1.7	157.8	-1.5
Disaster Reconstruction	503.5	-2.0	431.6	-14.3	483.8	12.1	492.3	1.8	694.7	41.1
Reserves	11.3	5.6	11.8	3.6	10.4	-11.9	10.6	1.9	10.6	0.3
Pensions	1,850.1	-0.7	1,895.6	2.5	1,879.8	-0.8	1,855.7	-1.3	1,837.4	-1.0
Civil Servants	121.4	-2.7	122.2	0.7	118.1	-3.4	111.8	-5.3	107.8	-3.6
Veterans	1,562.6	-1.0	1,606.9	2.8	1,599.0	-0.5	1,588.5	-0.7	1,580.5	-0.5
Other Pensions	155.9	4.0	157.6	1.1	154.4	-2.0	147.4	-4.5	141.0	-4.3
Administrative Costs	10.3	-0.1	8.9	-14.3	8.4	-5.6	8.0	-4.8	8.0	-0.2
Local Allocation Tax	9,734.7	0.5	11,086.2	13.9	13,031.2	17.5	14,964.7	14.8	15,930.8	6.5
National Debt Service	10,664.4	4.8	11,851.4	11.1	12,030.7	1.5	12,089.8	0.5	14,449.3	19.5
Defense	3,338.0	5.3	3,507.8	5.1	3,728.3	6.3	3,969.9	6.5	4,254.1	7.2
Economic Cooperation	600.5	3.3	661.3	10.1	714.4	8.0	750.6	5.1	802.1	6.9
Small Business Assistance	225.6	6.5	263.2	16.6	257.6	-2.1	240.5	-6.6	240.9	0.1
Energy Support	570.5	-8.9	496.8	-12.9	458.4	-7.7	546.1	19.1	547.1	0.2
Food Agency Account	613.6	-11.7	688.2	12.1	480.4	-30.2	459.2	-4.4	404.6	-11.9
Miscellaneous	4,104.0	-5.6	4,292.2	4.6	4,304.6	0.3	4,987.1	15.9	5,642.8	13.1
Reserves	200.0	0.0	200.0	0.0	200.0	0.0	200.0	0.0	325.0	62.5
Industrial Investment Special Account	0.0	0.0	458.0	100.0	1,300.0	183.8	1,300.0	0.0	1,300.0	0.0

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 5: Japan's Discretionary General Account Spending (Revised), FY 1986-FY 1990*

(in billions of yen and percent change)

	FY 1986		FY 1987		FY 1988		FY 1989		FY 1990	
Total Expenditures	Y53,824.8	1.1%	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%
Minus										
Debt Service and Transfers to Local Governments	20,399.1	2.7	22,937.6	12.4	25,061.9	9.3	27,054.5	8.0	30,380.1	12.3
Equals										
Discretionary Spending	33,425.8	0.2	35,276.5	5.5	36,789.8	4.3	39,257.4	6.7	39,271.0	0.0

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 6: Japan's General Account Revenues (Revised), FY 1986-FY 1990*

(in billions of yen and percent change)

	FY 1986		FY 1987		FY 1988		FY 1989		FY 1990	
Total Revenues	Y53,824.8	1.1%	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%
Tax and Stamp Revenues	39,440.0	3.4	43,087.0	9.3	48,106.0	11.7	54,227.0	12.7	59,131.0	9.0
Direct Taxes	29,469.0	3.1	31,703.0	7.6	36,284.0	14.5	41,541.0	14.5	44,842.0	7.9
Income Taxes	16,393.0	6.6	16,188.0	-1.3	16,928.0	4.6	20,057.0	18.5	24,345.0	21.4
Corporate Taxes	11,725.0	-3.9	13,722.0	17.0	17,712.0	29.1	19,577.0	10.5	18,637.0	-4.8
Inheritance and Gift Taxes	1,351.0	34.6	1,793.0	32.7	1,644.0	-8.3	1,907.0	16.0	1,860.0	-2.5
Indirect Taxes and Stamp Revenues	9,971.0	4.2	11,384.0	14.2	11,822.0	3.9	12,686.0	7.3	14,289.0	12.6
Liquor Taxes	1,974.0	1.0	2,042.0	3.4	2,066.0	1.2	1,801.0	-12.8	1,914.0	6.3
Gasoline Taxes	1,572.0	1.2	1,596.0	1.5	1,314.0	-17.7	1,365.0	3.9	1,423.0	4.2
Consumption Tax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3,618.0	100.0	4,870.0	34.6
Commodity Taxes	1,627.0	5.8	1,686.0	3.6	1,864.0	10.6	0.0	-100.0	0.0	0.0
Securities Transaction Tax	981.0	62.7	1,766.0	80.0	1,800.0	1.9	1,234.0	-31.4	1,020.0	-17.3
Stamp Revenues	1,462.0	7.0	1,806.0	23.5	1,973.0	9.2	1,849.0	-6.3	2,026.0	9.6
Monopoly Profits	7.6	15.2	6.0	-21.1	8.0	34.2	7.7	-3.8	8.3	7.8
Public Enterprise Receipts	16.7	5.0	17.5	4.8	16.7	-5.0	16.9	1.7	17.6	3.6
Sale of Public Properties	134.5	-14.8	180.6	34.3	126.1	-30.2	173.3	37.5	128.5	-25.9
Miscellaneous	2,289.7	1.6	2,044.7	-10.7	2,653.5	29.8	2,385.4	-10.1	2,505.3	5.0
Public Bonds	11,495.0	-7.6	10,539.0	-8.3	7,967.0	-24.4	7,111.0	-10.7	7,312.0	2.8
Carryover Surplus	441.3	114.8	2,339.4	430.1	2,974.6	27.2	2,390.6	-19.6	548.6	-77.1

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 7: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1986-FY 1990

(in billions of yen and percent change)

	FY 1986		FY 1987		FY 1988		FY 1989		FY 1990	
Total Outlays	Y22,155.1	6.2%	Y27,081.3	7.1%	Y29,614.0	9.4%	Y32,270.5	9.0%	Y34,572.4	7.1%
Housing	5,856.2	10.7	6,328.2	8.1	6,921.5	9.4	7,460.6	7.8	8,365.9	12.1
Other Social Infrastructure	3,694.5	12.6	3,998.7	8.2	4,450.9	11.3	4,371.3	-1.8	4,222.0	-3.4
Welfare	625.9	5.1	627.7	0.3	661.8	5.4	736.0	11.2	851.9	15.7
Education	678.2	-9.0	784.1	15.6	637.6	-18.7	520.2	-18.4	554.1	6.5
Small Business	3,700.0	-1.7	3,985.6	7.7	4,030.6	1.1	4,176.4	3.6	4,337.8	3.9
Agriculture	902.1	1.3	907.8	0.6	979.4	7.9	924.4	-5.6	876.0	-5.2
Land Conservation and Disaster Work	422.7	-10.6	493.0	16.6	409.8	-16.9	357.9	-12.7	328.5	-8.2
Roads	2,024.4	10.8	2,363.0	16.7	2,512.1	6.3	2,576.8	2.6	2,700.1	4.8
Transportation and Communications	2,015.1	14.3	2,264.1	12.4	2,229.9	-1.5	2,361.6	5.9	2,304.1	-2.4
Regional Development	566.1	10.7	657.7	16.2	652.2	-0.8	676.6	3.7	682.5	0.9
Industry and Technology	635.9	5.4	630.9	-0.8	687.2	8.9	758.7	10.4	796.5	5.0
Foreign Trade and Economic Cooperation	1,034.0	-7.2	690.5	-33.2	1,171.0	69.6	1,420.0	21.3	1,603.0	12.9
Cash Management	n.a.	n.a.	3,350.0	n.a.	4,270.0	27.5	5,930.0	38.9	6,950.0	17.2
Total Revenues	Y27,155.1	5.0%	Y31,081.3	14.5%	Y33,114.0	6.5%	Y34,570.5	4.4%	Y36,572.4	5.8%
Industrial Investment Special Account	61.5	95.9	144.3	134.6	91.2	-36.8	85.2	-6.6	64.1	-24.8
Trust Fund Bureau Fund	20,738.6	3.5	24,595.8	18.6	26,206.6	6.6	26,871.3	2.5	28,453.3	5.9
Postal Savings	7,000.0	9.4	7,900.0	12.9	7,900.0	0.0	8,500.0	7.6	7,200.0	-15.3
Pension Contributions	4,300.0	8.9	4,450.0	3.5	3,500.0	-21.3	4,310.0	23.1	5,540.0	28.5
Other Revenues	9,438.6	-2.5	12,245.8	29.7	14,806.6	20.9	14,061.3	-5.0	15,713.3	11.7
Postal Life Insurance Fund	3,145.0	21.5	3,941.2	25.3	4,409.4	11.9	5,614.0	27.3	6,055.0	7.9
Government-Guaranteed Bonds and Borrowings	3,210.0	0.0	2,400.0	-25.2	2,406.8	0.3	2,000.0	-16.9	2,000.0	0.0

Source: Ministry of Finance

Table 8: Japan's Industrial Production Index by Sector, 1986-1990

(1985 = 100)

	Total									
	Index	Change	Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment
1986	99.8	-0.2%	99.6	99.8	94.4	100.0	99.7	95.6	104.2	98.1
1987	103.2	3.4	90.3	103.2	96.3	107.6	103.2	95.9	113.7	96.8
1988	113.0	9.5	85.9	113.1	105.0	114.2	111.0	110.3	132.3	105.5
1989	119.9	6.1	81.8	120.1	106.9	122.1	116.1	122.2	142.1	116.2
1990	125.4	4.6	78.1	125.6	108.8	130.3	120.5	128.1	149.6	125.7

	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Food and Tobacco Products	Other
1986	104.5	96.8	103.2	96.4	101.8	103.0	95.9	101.1	100.7
1987	105.4	100.3	111.1	92.9	106.7	109.2	94.4	101.9	103.9
1988	114.1	109.6	120.4	96.7	113.3	118.7	94.5	103.6	109.8
1989	120.8	114.0	128.7	101.4	117.7	127.6	93.7	104.7	115.0
1990	136.0	119.2	134.4	110.4	122.5	133.2	90.8	105.3	121.5

Source: Ministry of International Trade and Industry

Table 9: Japan's Index of Industrial Production by End-Use Classification, 1986-1990

(1985 = 100)

	Final Demand Goods					
				Consumer Goods		
	Total	Capital Goods	Construction Materials	Durable	Nondurable	Producer Goods
1986	100.6	99.0	99.8	102.3	101.9	98.7
1987	103.2	102.2	105.5	101.5	104.5	103.1
1988	112.2	116.6	112.0	108.8	109.4	113.9
1989	119.1	128.7	116.5	112.4	113.6	120.9
1990	124.6	135.8	119.3	119.0	117.4	126.4

Source: Ministry of International Trade and Industry

Table 10: Japan's Index of Producers' Inventories of Finished Goods, 1986-1990

(1985 = 100)

	Total	Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment
1986	101.1	163.0	100.9	96.2	101.0	98.4	104.3	103.6	93.8
1987	97.4	264.3	96.9	89.4	93.6	100.6	95.4	98.8	92.4
1988	99.0	276.4	98.4	91.6	89.7	103.9	94.4	104.1	90.4
1989	106.8	261.2	106.3	92.3	98.8	110.2	104.1	128.3	98.2
1990	109.3	216.6	108.9	92.2	103.0	112.8	107.3	125.1	92.6

	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Food and Tobacco Products	Other
1986	118.8	104.4	102.3	99.4	100.5	104.6	103.3	99.4	99.1
1987	112.8	98.7	98.2	98.5	99.8	107.2	97.0	95.5	95.9
1988	101.5	96.4	102.3	99.7	104.8	106.4	98.7	93.2	103.7
1989	113.8	99.9	112.8	104.3	112.2	122.8	103.8	86.1	113.1
1990	101.2	104.3	118.7	113.5	112.2	134.0	107.1	91.8	120.1

Source: Ministry of International Trade and Industry

Table 11: Japan's Index of Consumption of Materials, 1986-1990

(1985 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Other Industries
1986	96.1	89.7	100.2	99.3	94.9	99.1	99.5	95.7	102.1	101.7	94.3	97.6
1987	97.6	90.4	104.7	104.9	95.2	102.9	105.7	93.1	108.3	106.9	94.0	101.1
1988	105.4	98.9	111.5	110.2	105.5	111.3	113.7	96.5	116.1	115.0	93.6	104.0
1989	110.6	102.0	115.1	114.6	111.8	115.5	120.9	101.4	121.3	122.7	93.1	106.1
1990	115.9	104.8	121.8	116.5	119.2	119.8	126.0	109.3	126.7	126.7	90.6	106.0

Source: Ministry of International Trade and Industry

Table 12: Japan's Index of Inventories of Materials, 1986-1990

(1985 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Other Industries
1986	95.1	98.2	77.7	92.2	89.1	94.9	99.6	99.6	89.7	94.8	93.4	99.6
1987	91.4	91.8	64.3	88.0	82.6	90.8	100.0	97.0	99.7	90.7	91.6	100.5
1988	94.7	97.3	65.0	91.6	91.1	92.8	100.4	97.9	102.9	96.1	95.9	100.1
1989	95.0	97.8	63.4	93.6	97.2	100.1	105.0	88.6	104.2	102.8	97.1	102.1
1990	97.0	101.9	63.9	94.9	102.6	105.4	105.9	87.8	108.1	104.6	96.5	104.3

Source: Ministry of International Trade and Industry

Table 13: Japan's Index of Manufacturing Operating Rates, 1986-1990

(1985 = 100)

	Total	Steel	Non-ferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles
1986	95.4	93.9	98.8	98.5	87.7	92.4	95.9	95.2	96.7	99.9	95.9	102.8	99.1
1987	95.5	95.6	104.8	103.4	83.1	90.1	95.0	88.8	95.4	104.3	97.4	109.6	98.2
1988	101.1	105.9	109.1	112.5	94.3	91.6	98.6	93.3	101.6	109.5	104.1	118.6	99.8
1989	103.3	110.4	111.6	119.5	100.1	88.6	102.2	83.7	106.0	111.0	110.6	124.3	100.0
1990	105.7	114.2	114.3	121.8	102.6	92.3	103.2	90.3	111.7	111.8	120.1	127.0	99.7

Source: Ministry of International Trade and Industry

Table 14: Residential Construction Starts in Japan, 1986-1990

(units)

		Type of Housing		Owner-Occupant Relationship			
	Total	Public	Private	Owner-Built	Developer-Built	Rental Units	Other
1986	1,364,609	80,780	1,283,829	477,050	220,155	645,886	21,518
1987	1,674,300	80,719	1,593,581	546,316	246,861	858,726	22,397
1988	1,684,644	84,466	1,600,178	508,660	293,311	858,665	24,008
1989	1,662,612	78,674	1,583,938	504,228	312,005	817,186	29,193
1990	1,707,109	78,494	1,628,615	486,527	379,600	806,097	34,885

Source: Ministry of Construction

Table 15: Japan's Labor Force Survey, 1986-1990

(in thousands of persons)

	Working-Age Population*	Total Labor Force	Employed Labor Force	Totally Unemployed Labor Force	Unemployment Rate	Not in Labor Force	Ratio of Job Openings to Applications**
1986	95,870	60,200	58,530	1,670	2.8%	35,130	0.62
1987	97,200	60,840	59,110	1,730	2.8	35,840	0.70
1988	98,490	61,660	60,110	1,550	2.5	36,350	1.01
1989	99,740	62,700	61,280	1,420	2.3	36,550	1.26
1990	100,890	63,840	62,490	1,340	2.1	36,570	1.40

*People 15 years old and over.
**Excludes applications by new school graduates but includes those by people seeking part-time work.

Source: Management and Coordination Agency and Ministry of Labor

Table 16: Employment Index of Regular Workers in Japan, 1986-1990*

(1990 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1986	92.8	134.3	91.0	97.1	93.0	105.8	95.5	97.8	98.1	88.6	97.8	114.3	98.1	111.5
1987	93.3	125.4	93.2	95.6	94.4	103.6	95.0	101.0	98.2	90.1	98.7	108.2	97.5	105.3
1988	94.7	117.1	95.3	96.2	96.0	101.9	95.8	101.7	98.1	93.6	99.4	103.0	97.0	101.2
1989	97.1	107.7	97.5	97.9	97.7	100.8	98.2	99.4	98.2	96.6	99.5	100.2	97.5	101.0
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Utilities	Transportation and Communications	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Services
1986	97.3	91.4	96.2	96.9	97.8	103.9	101.1	100.3	87.4	92.5	79.3	87.2
1987	96.5	91.7	94.1	94.7	93.3	99.5	101.5	97.4	90.4	95.3	82.9	89.5
1988	96.2	94.1	94.4	95.9	92.9	98.4	101.0	97.2	92.7	96.2	86.7	92.2
1989	97.8	97.3	96.9	97.8	96.1	100.1	100.0	98.6	95.7	98.0	92.4	95.8
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Establishments with 30 or more regular workers.

Source: Ministry of Labor

Table 17: Nominal Wage Index of Regular Workers in Japan, 1986-1990*

(1990 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1986	86.9	86.4	81.2	84.5	85.7	86.7	82.6	81.5	87.6	95.9	83.7	81.9	85.0	83.8
1987	88.6	87.5	83.4	85.9	87.0	89.7	84.5	84.7	89.5	96.2	86.6	84.5	87.0	82.3
1988	91.7	89.6	87.6	89.8	88.2	91.9	88.4	88.2	92.2	94.6	90.3	90.0	92.7	86.6
1989	95.5	94.5	93.3	95.0	93.4	96.6	94.8	93.6	99.1	95.3	95.5	95.5	96.4	93.7
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Utilities	Transportation and Communications	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Services
1986	83.4	85.6	83.3	82.1	84.6	81.1	85.8	84.6	87.5	92.1	79.1	91.4
1987	85.6	86.3	84.3	84.8	84.9	81.8	87.7	87.7	88.8	94.6	81.5	92.4
1988	89.8	89.9	89.9	88.6	91.1	88.0	90.9	91.9	91.3	97.6	85.1	93.9
1989	93.9	95.9	94.6	94.4	95.3	93.0	95.0	95.6	95.2	99.3	95.9	95.7
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Establishments with 30 or more regular workers.

Source: Ministry of Labor

Table 18: Average Monthly Wages of Manufacturing Employees in Japan by Industry, 1986-1990

(in thousands of yen)

	Total	Foods and Tobacco	Textiles	Pulp and Paper Products	Chemicals	Nonmetallic Mineral Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1986	Y305.4	Y250.6	Y216.9	Y322.0	Y402.8	Y299.2	Y392.1	Y345.1	Y298.5	Y334.9	Y283.6	Y348.3	Y288.9
1987	313.2	259.6	224.2	331.7	419.2	308.1	385.2	354.6	302.6	340.7	296.2	352.4	292.2
1988	318.7	245.4	227.3	329.5	421.5	325.9	403.9	373.6	312.6	362.7	299.1	369.6	310.5
1989	336.6	256.7	239.2	351.1	443.6	338.1	438.3	389.7	333.6	380.6	318.9	388.7	325.7
1990	352.0	263.0	250.4	349.4	460.0	350.7	467.3	414.6	350.8	399.2	338.5	405.6	349.1

Note: Includes overtime pay and bonuses.

Source: Ministry of Labor

Table 19: Index of Labor Productivity in Japan, 1986-1990

(1985 = 100)

	Total	Mining	Manufacturing	Foods	Textiles	Lumber and Wood Products	Pulp and Paper Products	Nonmetallic Mineral Products	Rubber Products	Chemicals
1986	101.9	108.4	101.8	101.4	100.8	112.9	105.7	99.8	99.7	104.2
1987	107.8	123.8	107.7	100.4	102.5	107.3	113.3	105.6	104.9	113.2
1988	120.2	137.0	120.1	104.6	107.8	112.9	123.5	125.5	112.0	122.2
1989	127.7	141.0	127.6	108.0	109.8	108.7	133.5	133.0	118.3	132.3
1990	133.1	151.3	133.0	105.4	110.2	104.6	139.1	140.9	121.4	140.6

	Plastic Products	Petroleum and Coal Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1986	100.2	103.5	97.9	101.2	102.1	97.3	102.9	101.0	109.1
1987	105.6	107.4	107.1	109.1	108.4	102.8	114.5	102.9	118.1
1988	111.9	119.6	121.5	114.6	116.5	119.3	134.5	113.0	138.7
1989	115.0	131.5	128.3	122.3	119.4	132.9	144.7	120.4	148.1
1990	120.7	146.7	133.3	130.4	121.3	135.9	150.5	129.0	167.9

Source: Japan Productivity Center

Table 20: Japan's Consumer Price Index, 1986-1990

(1985 = 100)

	Total		Food	Housing	Utilities	Furniture and Housewares	Clothing	Medical Care	Transportation	Education	Recreation	Miscellaneous
	Index	Change										
1986	100.6	0.6%	100.2	102.5	95.0	100.0	102.2	101.9	99.3	103.6	101.5	102.0
1987	100.7	0.1	99.3	105.4	88.0	99.4	103.3	103.8	100.0	107.1	102.0	103.2
1988	101.4	0.7	100.0	107.6	85.9	98.9	104.5	104.2	99.5	110.7	102.6	103.6
1989	103.7	2.3	102.2	110.8	85.6	99.4	109.1	105.8	100.6	115.1	105.9	105.1
1990	106.9	3.1	106.3	114.2	87.6	99.5	114.3	106.3	102.0	120.8	109.5	106.3

Source: Management and Coordination Agency

Table 21: Japan's Wholesale Price Index by Industry, 1986-1990

(1985 = 100)

	Total											
	Index	Change	Foods	Textiles	Lumber and Wood Products	Pulp, Paper and Paper Products	Chemicals	Plastic Products	Petroleum and Products	Nonmetallic Mineral Products	Steel	Nonferrous Metals
1986	90.9	-9.1%	99.4	91.8	95.2	96.3	89.4	95.6	76.9	98.1	90.1	83.2
1987	87.5	-3.7	98.5	90.5	105.0	94.5	85.7	92.1	64.3	96.5	86.9	83.1
1988	86.6	-1.0	97.9	90.3	103.2	95.3	86.1	92.2	60.8	95.8	90.7	90.6
1989	88.8	2.5	99.1	93.0	111.1	98.3	86.0	94.3	63.9	97.9	95.2	96.7
1990	90.6	2.0	101.6	93.8	115.7	98.9	88.2	96.0	73.8	100.6	95.5	94.7

	Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Miscellaneous Manufactures	Agricultural, Forestry and Fishery Products	Mining Products	Utilities
1986	98.4	96.3	89.8	94.8	98.2	97.3	91.0	56.4	95.3
1987	95.6	93.8	84.3	92.6	97.4	95.3	86.7	50.8	89.0
1988	97.7	93.4	80.4	90.8	94.4	95.8	87.2	45.6	84.0
1989	101.5	96.4	79.7	91.9	93.1	99.7	89.8	50.2	81.1
1990	103.9	99.1	77.8	93.2	94.9	102.3	91.4	57.6	80.4

Source: Bank of Japan

Table 22: Japan's Wholesale Price Index by End-Use Classification, 1986-1990

(1985 = 100)

	Domestic Products										Exports			
			Intermediate Goods				Final Goods							
								Consumer Goods						
	Total	Raw Materials	Total	Semi-finished Goods	Con-struction Materials	Fuels and Energy	Capital Goods	Total	Durables	Nondurables	Total	Semi-finished Goods	Capital Goods	Consumer Goods
1986	91.8	66.5	92.0	91.3	97.5	85.6	97.7	98.0	97.4	98.1	84.9	80.0	89.2	87.0
1987	88.5	62.4	88.2	87.7	98.7	74.7	95.5	95.7	94.5	96.2	80.6	75.7	85.2	82.7
1988	87.8	59.9	88.2	88.5	100.4	69.9	95.2	93.9	90.9	95.0	78.8	75.9	83.2	78.3
1989	89.8	64.4	90.7	91.2	104.9	69.6	97.6	93.9	86.2	96.8	82.3	81.0	86.6	80.5
1990	91.7	69.6	92.4	92.0	108.6	73.5	99.1	94.9	84.6	98.8	84.0	81.3	89.4	83.0

Source: Bank of Japan

Table 23: Japan's Global Balance of Payments, 1986-1990

(in millions of dollars, IMF value basis, seasonally unadjusted)

		Trade Balance	Exports	Imports	Services	Transfers	Current Account Balance	Long-Term Capital	Basic Balance	Short-Term Capital	Errors and Omissions	Overall Balance	Gold and Foreign Exchange Reserves*
1986		$92,827	$205,591	$112,764	$-4,932	$-2,050	$85,845	$-131,461	$-45,616	$-1,609	$2,458	$-44,767	$42,239
1987		96,386	224,605	128,219	-5,702	-3,669	87,015	-136,532	-49,517	23,865	-3,893	-29,545	81,479
1988		95,012	259,765	164,753	-11,263	-4,118	79,631	-130,930	-51,299	19,521	2,796	-28,982	97,662
1989		76,917	269,570	192,653	-15,526	-4,234	57,157	-89,246	-32,089	20,811	-22,008	-33,286	84,895
1990		63,528	280,374	216,846	-22,292	-5,475	35,761	-43,586	-7,825	21,468	-20,877	-7,234	77,053
1989	January	4,887	19,033	14,146	-2,196	-186	2,505	-4,580	-2,075	2,447	2,387	2,759	98,177
	February	8,521	22,017	13,496	-994	-272	7,255	-3,511	3,744	4,295	-2,849	5,190	98,830
	March	7,903	25,895	17,992	-405	-1,194	6,304	2,479	8,783	2,892	4,330	16,005	99,353
	April	8,098	22,804	14,706	-1,288	-229	6,581	-16,368	-9,787	-4,821	-8,624	-23,232	100,361
	May	5,162	21,387	16,225	-1,531	-192	3,439	-12,511	-9,072	-3,173	-211	-12,456	95,694
	June	6,534	22,369	15,835	-2,073	-198	4,263	-1,922	2,341	6,851	-384	8,808	89,462
	July	7,028	23,027	15,999	-1,348	-182	5,498	-7,188	-1,690	-2,329	-6,820	-10,839	88,865
	August	4,872	21,447	16,575	-1,153	-289	3,430	-3,626	-196	2,416	-793	1,427	88,318
	September	7,870	23,683	15,813	-1,522	-319	6,029	-10,745	-4,716	16,986	-3,931	8,339	86,117
	October	5,485	22,437	16,952	-1,446	-306	3,733	-25,677	-21,944	-14,734	-188	-36,866	84,293
	November	4,133	21,410	17,277	261	-287	4,107	-8,821	-4,714	4,907	38	231	84,747
	December	6,424	24,061	17,637	-1,831	-580	4,013	3,224	7,237	5,074	-4,963	7,348	84,895
1990	January	1,069	18,216	17,147	-1,393	-235	-559	-2,698	-3,257	-1,124	-144	-4,525	82,717
	February	5,352	21,646	16,294	-341	-194	4,817	-7,905	-3,088	4,846	3,458	5,216	80,443
	March	7,972	25,598	17,626	1,033	-958	8,047	-5,483	2,564	4,436	-7,757	-757	73,496
	April	3,976	21,218	17,242	-1,821	-195	1,960	-5,377	-3,417	-12,321	-4,098	-19,836	73,024
	May	2,618	21,162	18,544	-1,140	-79	1,399	-5,607	-4,208	10,023	3,076	8,891	73,557
	June	7,020	23,130	16,110	-2,318	-169	4,533	-8,001	-3,468	5,433	1,043	3,008	73,649
	July	5,323	23,404	18,081	-3,038	-360	1,925	-8,062	-6,137	-3,668	-2,927	-12,732	74,585
	August	4,061	21,941	17,880	-2,941	-270	850	-4,886	-4,036	3,807	79	-150	75,315
	September	7,765	25,155	17,390	-2,066	-1,074	4,625	5,701	10,326	4,257	-3,798	10,785	75,323
	October	5,838	26,087	20,249	-2,725	-419	2,694	7,031	9,725	-4,259	-5,937	-471	76,190
	November	4,432	25,054	20,622	-2,481	-266	1,685	-2,932	-1,247	4,306	2,842	5,901	76,672
	December	8,102	27,763	19,661	-3,061	-1,256	3,785	-5,367	-1,582	5,732	-6,714	-2,564	77,053

*End of period.

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan and Ministry of Finance

Table 24: Japan's Balance of Payments with the United States, 1986-1990

(in millions of dollars, IMF value basis)

	1986	1987	1988	1989	1990
Merchandise Trade Balance	$54,919	$57,117	$52,448	$49,404	$41,869
Exports	80,385	83,010	89,146	92,741	89,223
Imports	25,466	25,893	36,698	43,337	47,354
Services Balance	-585	1,021	115	-1,198	-3,387
Transportation	243	-698	-1,132	-1,610	-2,513
Travel	-2,012	-3,106	-5,721	-7,554	-8,301
Investment Income	3,231	7,300	11,364	14,318	16,257
Other	-2,047	-2,475	-4,396	-6,352	-8,830
Official	1,931	1,751	1,578	1,307	1,068
Private	-3,978	-4,226	-5,974	-7,659	-9,898
Unilateral Transfers Balance	-552	-1,460	-1,243	-723	-829
Official	-92	-779	-588	-613	-757
Private	-460	-681	-655	-110	-72
Current Account Balance	53,782	56,678	51,320	47,483	37,653
Long-Term Capital (net)	-65,650	-61,030	-59,260	-53,861	-11,719
Direct Investments (net)	-7,774	-9,018	-19,568	-22,768	-24,986
Trade Credits (net)	-334	-489	-1,024	-1,255	-633
Loans (net)	-690	-1,663	-2,830	-4,761	-2,783
Stocks and Bonds (net)	-55,944	-48,223	-33,320	-22,074	19,849
Other (net)	-908	-1,637	-2,518	-3,003	-3,166
Basic Balance	-11,868	-4,352	-7,940	-6,378	25,934

Note: For long-term capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan

Table 25: Japan's Exports and Imports in Dollar Terms, 1986-1990

(in millions of dollars, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		$209,151	19.1%	$126,408	-2.4%	$82,743
1987		229,221	9.6	149,515	18.3	79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1989	January	19,359	11.7	16,113	13.0	3,246
	February	22,379	10.6	15,149	1.0	7,230
	March	26,489	16.6	19,881	30.3	6,608
	April	23,218	3.3	15,930	1.5	7,288
	May	21,702	5.1	17,946	16.1	3,756
	June	22,683	2.9	17,416	8.2	5,266
	July	23,456	1.3	17,461	9.4	5,995
	August	21,825	4.7	18,458	16.3	3,367
	September	24,314	4.9	17,129	11.1	7,186
	October	23,019	-1.8	18,368	16.6	4,651
	November	22,078	-2.7	18,550	15.1	3,528
	December	24,655	-5.8	18,446	12.1	6,208
1990	January	18,669	-3.6	18,349	13.9	319
	February	22,002	-1.7	17,035	12.5	4,968
	March	26,034	-1.7	18,999	-4.4	7,034
	April	21,912	-5.6	18,394	15.5	3,518
	May	21,548	-0.7	18,458	2.9	3,090
	June	23,772	4.8	17,102	-1.8	6,669
	July	23,910	1.9	18,576	6.4	5,334
	August	22,430	2.8	19,008	3.0	3,422
	September	25,850	6.3	18,964	10.7	6,886
	October	26,718	16.1	23,486	27.9	3,232
	November	25,739	16.6	23,500	26.7	2,239
	December	28,366	15.1	22,929	24.3	5,437

Source: Ministry of Finance

Table 26: Japan's Exports and Imports in Yen Terms, 1986-1990

(in billions of yen, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		Y35,290	-15.9%	Y21,551	-30.7%	Y13,739
1987		33,315	-5.6	21,737	0.9	11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1989	January	2,437	11.4	2,024	12.7	413
	February	2,876	10.5	1,947	1.0	929
	March	3,392	16.1	2,545	29.6	847
	April	3,068	8.6	2,105	6.7	963
	May	2,908	12.9	2,401	24.5	507
	June	3,247	17.6	2,492	23.6	755
	July	3,320	9.2	2,473	17.8	848
	August	3,061	10.3	2,590	22.5	472
	September	3,529	13.5	2,485	20.1	1,044
	October	3,286	6.2	2,619	25.4	668
	November	3,151	10.9	2,647	31.0	504
	December	3,548	10.8	2,653	31.9	895
1990	January	2,699	10.8	2,649	30.9	50
	February	3,190	10.9	2,469	26.8	721
	March	3,876	14.3	2,824	11.0	1,053
	April	3,445	12.3	2,888	37.2	557
	May	3,380	16.3	2,900	20.8	481
	June	3,624	11.6	2,604	4.5	1,020
	July	3,626	9.2	2,823	14.2	803
	August	3,340	9.1	2,830	9.3	509
	September	3,686	4.4	2,711	9.1	975
	October	3,573	8.7	3,143	20.0	430
	November	3,302	4.8	3,015	13.9	287
	December	3,717	4.8	3,001	13.1	716

Source: Ministry of Finance

Table 27: Japan's Export and Import Quantum (Volume) Indexes, 1986-1990

(1985 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1986		98.8	-1.2%	109.4	9.4%
1987		99.2	0.4	119.3	9.0
1988		103.6	4.4	139.1	16.7
1989		107.9	4.2	150.1	7.9
1990		114.0	5.7	159.1	6.0
1989	January	87.3	6.3	144.8	13.0
	February	101.8	5.4	132.3	-2.6
	March	121.2	12.4	169.1	23.4
	April	107.0	1.9	134.9	-4.4
	May	100.6	4.4	150.4	10.3
	June	109.3	6.4	146.8	4.9
	July	111.4	1.5	146.1	2.9
	August	104.9	6.3	156.6	13.3
	September	118.9	7.0	146.4	7.3
	October	110.4	0.4	157.0	13.4
	November	104.5	0.4	158.1	8.3
	December	117.2	-0.9	158.9	5.7
1990	January	88.6	1.5	156.6	8.1
	February	103.8	2.0	142.1	7.4
	March	126.2	4.1	160.7	-5.0
	April	109.6	2.4	159.1	17.9
	May	108.8	8.2	160.7	6.8
	June	118.2	8.1	148.5	1.2
	July	118.3	6.2	162.5	11.2
	August	109.7	4.6	163.9	4.7
	September	121.1	1.9	151.2	3.3
	October	122.4	10.9	171.0	8.9
	November	114.7	9.8	166.1	5.1
	December	126.4	7.8	167.1	5.2

Source: Ministry of Finance

Table 28: Japan's Export and Import Yen-Based Price Indexes, 1986-1990

(1985 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1986		84.9	-15.1%	64.2	-35.8%
1987		80.6	-5.1	58.9	-8.3
1988		78.8	-2.2	56.2	-4.6
1989		82.3	4.4	60.5	7.7
1990		84.0	2.1	65.7	8.6
1989	January	79.2	2.3	55.4	-1.4
	February	79.4	2.1	56.7	0.7
	March	80.2	3.2	57.8	2.3
	April	80.6	3.5	59.4	6.8
	May	82.1	5.7	61.5	10.6
	June	84.2	7.5	62.9	10.7
	July	83.3	3.9	62.0	6.9
	August	83.0	2.7	61.8	7.1
	September	84.2	3.8	62.6	8.3
	October	83.3	4.4	61.7	9.2
	November	83.8	7.0	61.9	14.8
	December	83.8	7.2	61.9	15.3
1990	January	84.2	6.3	62.6	13.0
	February	84.2	6.0	63.4	11.8
	March	86.1	7.4	65.9	14.0
	April	87.9	9.1	67.3	13.3
	May	86.5	5.4	65.8	7.0
	June	86.1	2.3	64.8	3.0
	July	85.2	2.3	63.2	1.9
	August	85.1	2.2	64.0	3.6
	September	82.3	-2.3	66.4	6.1
	October	80.0	-4.0	67.7	9.7
	November	79.8	-4.8	68.4	10.5
	December	81.1	-3.2	69.0	11.5

Source: Bank of Japan

Table 29: Yen-Dollar Exchange Rate Used to Convert Customs Clearance Trade Data, 1986-1990*

	Exports	Imports
1986 Average	Y169.99	Y170.08
1987 Average	145.90	146.01
1988 Average	128.13	128.15
1989 Average	137.34	137.26
1990 Average	145.10	145.09
1989 January	125.88	125.64
February	128.50	128.49
March	128.06	128.00
April	132.12	132.12
May	133.[illegible]	133.78
June	143.14	143.06
July	141.54	141.60
August	140.27	140.29
September	145.15	145.10
October	142.77	142.58
November	142.72	142.67
December	143.91	143.83
1990 January	144.57	144.36
February	144.98	144.93
March	148.90	148.61
April	157.20	156.99
May	156.86	157.09
June	152.45	152.28
July	151.64	151.95
August	148.89	148.90
September	142.59	142.96
October	133.73	133.82
November	128.30	128.31
December	131.03	130.86

*Reflects the exchange rate that prevailed at the time export or import contracts were signed.

Source: Ministry of Finance

Table 30: Yen-Dollar Exchange Rate on Tokyo Foreign Exchange Market, 1986-1990

(average for period)

	1986	1987	1988	1989	1990
Average	Y168.52	Y144.64	Y128.15	Y137.96	Y144.79
January	200.07	154.48	127.56	127.23	145.09
February	184.64	153.48	129.16	127.77	145.53
March	178.93	151.54	127.28	130.36	153.08
April	175.62	142.98	124.93	132.08	158.47
May	166.83	140.54	124.77	138.35	153.52
June	167.95	144.48	127.14	143.79	153.77
July	158.60	150.21	133.07	140.72	149.28
August	154.00	147.56	133.63	141.11	147.42
September	154.72	143.00	134.44	145.05	138.99
October	155.95	143.54	129.02	141.93	129.73
November	162.64	135.25	123.19	143.52	129.08
December	162.29	128.59	123.63	143.66	133.55

Source: International Monetary Fund

Table 31: Japan's Exports by Major Market, 1986-1990

(in millions of dollars, f.o.b. value basis)

	1986	1987	1988	1989	1990
Total Exports	$209,151	$229,221	$264,917	$275,175	$286,948
Developed Countries	131,149	142,883	161,847	167,358	169,964
United States	80,456	83,580	89,634	93,189	90,322
Canada	5,526	5,611	6,424	6,807	6,727
Western Europe	37,483	45,555	56,023	56,494	63,332
United Kingdom	6,647	8,400	10,632	10,741	10,786
Netherlands	3,261	4,071	5,054	5,112	6,165
Belgium	2,198	2,697	3,390	3,455	3,807
France	3,152	4,014	4,987	5,298	6,128
West Germany	10,477	12,833	15,793	15,920	17,782
Spain	1,076	1,343	1,860	1,942	2,092
Italy	1,723	2,103	2,787	2,783	3,409
European Community	30,675	37,693	46,873	47,908	53,518
Sweden	1,438	1,931	2,320	2,174	1,954
Switzerland	1,887	2,266	2,775	2,664	2,931
Austria	764	1,006	1,406	1,327	1,616
Australia	5,227	5,146	6,680	7,805	6,900
New Zealand	1,103	1,128	1,039	1,346	1,206
South Africa	1,355	1,863	2,047	1,717	1,477
Developing Countries	63,934	74,402	89,250	95,173	107,142
Latin America	9,495	8,760	9,297	9,381	10,280
Mexico	1,032	1,389	1,772	1,908	2,271
Panama	3,197	2,416	2,653	2,512	2,893
Chile	294	353	368	636	483
Brazil	973	879	998	1,310	1,225
Southeast Asia	41,788	52,982	67,109	73,516	82,721
South Korea	10,475	13,229	15,441	16,561	17,457
Taiwan	7,852	11,346	14,354	15,421	15,430
Hong Kong	7,161	8,872	11,706	11,526	13,072
Thailand	2,030	2,953	5,162	6,838	9,126
Singapore	4,577	6,008	8,311	9,239	10,708
Malaysia	1,708	2,168	3,060	4,124	5,511
Philippines	1,088	1,415	1,740	2,381	2,504
Indonesia	2,662	2,990	3,054	3,301	5,040
India	2,099	1,957	2,082	2,018	1,708
Middle East and North Africa	9,795	9,177	9,438	8,559	9,877
Iran	1,145	1,043	808	922	1,617
Saudi Arabia	2,762	3,239	3,142	2,763	3,341
Kuwait	1,220	857	731	671	398
Qatar	148	151	173	211	152
Oman	288	262	348	334	420
United Arab Emirates	1,033	1,118	1,286	1,296	1,550
Subsaharan Africa	2,178	2,894	2,760	2,892	3,409
Communist Countries	14,064	11,924	13,818	12,644	9,842
China	9,856	8,250	9,476	8,516	6,130
U.S.S.R.	3,150	2,563	3,130	3,082	2,563

Source: Ministry of Finance

Table 32: Japan's Imports by Major Supplier, 1986-1990

(in millions of dollars, c.i.f. value basis)

	1986	1987	1988	1989	1990
Total Imports	$126,408	$149,515	$187,354	$210,847	$234,799
Developed Countries	62,233	71,610	94,785	107,313	119,316
United States	29,054	31,491	42,037	48,246	52,369
Canada	4,895	6,073	8,308	8,645	8,392
Western Europe	18,118	22,749	30,578	35,126	42,617
United Kingdom	3,573	3,057	4,193	4,466	5,239
Netherlands	577	757	996	1,122	1,170
Belgium	677	859	1,125	1,430	1,557
France	1,855	2,871	4,315	5,546	7,590
West Germany	4,298	6,150	8,101	8,995	11,487
Spain	297	357	537	556	793
Italy	1,495	2,135	2,895	3,806	5,008
European Community	13,989	17,670	24,071	28,146	35,028
Sweden	575	682	977	1,086	1,292
Switzerland	2,571	3,101	3,565	3,863	4,082
Austria	247	349	442	521	705
Australia	6,980	7,869	10,285	11,605	12,369
New Zealand	956	1,168	1,644	1,657	1,727
South Africa	2,229	2,259	1,933	2,035	1,843
Developing Countries	55,941	67,277	78,704	87,946	98,502
Latin America	6,194	6,356	8,313	8,871	9,851
Mexico	1,439	1,625	1,591	1,730	1,931
Panama	84	69	137	85	111
Chile	535	617	1,023	1,322	1,622
Brazil	1,875	2,032	2,950	2,999	3,173
Southeast Asia	29,489	38,627	47,802	52,906	54,601
South Korea	5,292	8,076	11,811	12,994	11,707
Taiwan	4,691	7,128	8,744	8,979	8,496
Hong Kong	1,074	1,561	2,109	2,219	2,173
Thailand	1,391	1,796	2,751	3,583	4,147
Singapore	1,463	2,048	2,339	2,952	3,571
Malaysia	3,846	4,772	4,710	5,107	5,402
Philippines	1,221	1,353	2,044	2,060	2,157
Indonesia	7,311	8,427	9,497	11,021	12,721
India	1,297	1,530	1,804	1,978	2,075
Middle East and North Africa	18,427	20,197	19,602	23,054	31,336
Iran	1,383	1,556	1,164	1,792	3,460
Saudi Arabia	5,205	7,311	6,348	7,048	10,462
Kuwait	1,157	1,796	1,590	2,339	1,711
Qatar	1,127	880	1,139	1,546	2,153
Oman	1,616	1,414	1,690	1,530	1,957
United Arab Emirates	5,947	5,408	5,324	6,051	9,085
Subsaharan Africa	1,356	1,435	2,011	2,043	1,877
Communist Countries	8,232	10,628	13,863	15,584	16,977
China	5,652	7,401	9,859	11,146	12,054
U.S.S.R.	1,972	2,352	2,766	3,005	3,351

Source: Ministry of Finance

Table 33: Japan's Trade Balance with Major Trading Partners, 1986-1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1986	1987	1988	1989	1990
Overall Balance	$82,743	$79,706	$77,563	$64,328	$52,149
Developed Countries	68,917	71,273	67,062	60,045	50,648
United States	51,401	52,090	47,597	44,943	37,954
Canada	631	-462	-1,884	-1,838	-1,666
Western Europe	19,365	22,806	25,445	21,368	20,715
United Kingdom	3,073	5,343	6,439	6,275	5,547
Netherlands	2,684	3,314	4,059	3,991	4,996
Belgium	1,521	1,837	2,265	2,024	2,250
France	1,297	1,143	672	-247	-1,462
West Germany	6,180	6,682	7,692	6,925	6,295
Spain	779	987	1,324	1,385	1,300
Italy	228	-32	-108	-1,023	-1,600
European Community	16,687	20,024	22,802	19,761	18,490
Sweden	864	1,250	1,343	1,088	661
Switzerland	-684	-835	-790	-1,199	-1,151
Austria	517	658	964	806	910
Australia	-1,754	-2,723	-3,604	-3,800	-5,469
New Zealand	147	-41	-605	-310	-521
South Africa	-874	-396	114	-318	-366
Developing Countries	7,993	7,126	10,546	7,227	8,640
Latin America	3,301	2,405	984	510	429
Mexico	-407	-236	182	178	340
Panama	3,113	2,348	2,516	2,427	2,782
Chile	-240	-264	-655	-686	-1,139
Brazil	-902	-1,154	-1,952	-1,689	-1,948
Southeast Asia	12,299	14,355	19,307	20,611	28,120
South Korea	5,183	5,154	3,631	3,567	5,751
Taiwan	3,161	4,218	5,611	6,442	6,934
Hong Kong	6,087	7,312	9,598	9,307	10,899
Thailand	639	1,157	2,410	3,256	4,979
Singapore	3,113	3,961	5,972	6,287	7,137
Malaysia	-2,137	-2,604	-1,650	-983	110
Philippines	-133	62	-304	321	347
Indonesia	-4,649	-5,437	-6,443	-7,720	-7,682
India	802	427	277	41	-367
Middle East and North Africa	-8,632	-11,020	-10,164	-14,496	-21,459
Iran	-239	-512	-356	-870	-1,843
Saudi Arabia	-2,443	-4,072	-3,206	-4,285	-7,120
Kuwait	63	-939	-860	-1,668	-1,314
Qatar	-979	-729	-967	-1,335	-2,001
Oman	-1,328	-1,152	-1,342	-1,196	-1,537
United Arab Emirates	-4,915	-4,290	-4,038	-4,755	-7,534
Subsaharan Africa	822	1,459	749	849	1,532
Communist Countries	5,832	1,297	-44	-2,940	-7,135
China	4,204	848	-383	-2,630	-5,924
U.S.S.R.	1,178	211	364	77	-788

Source: Ministry of Finance

Table 34: Japan's Exports by Commodity, 1986-1990

(in millions of dollars, f.o.b. value basis)

	1986	1987	1988	1989	1990
Total Exports	$209,151	$229,221	$264,917	$275,175	$286,948
Food and Live Animals	1,366	1,424	1,568	1,547	1,482
Fish and Fish Products	766	732	781	747	664
Beverages and Tobacco	110	121	129	140	164
Crude Materials (excl. fuels)	1,414	1,490	1,761	1,829	1,838
Rubber	365	400	472	469	504
Textile Fibers and Waste	695	708	848	827	838
Mineral Fuels	588	782	596	972	1,283
Petroleum Products	379	550	359	692	1,100
Animal and Vegetable Oils and Fats	91	85	157	83	98
Chemicals	9,484	11,662	13,964	14,776	15,872
Chemical Elements and Compounds	3,953	4,979	6,000	6,627	6,857
Organic Chemicals	3,141	4,017	4,892	5,440	5,640
Inorganic Chemicals	799	941	1,082	1,156	1,188
Dyeing, Tanning and Coloring Materials	707	857	1,028	1,108	1,224
Pharmaceuticals	513	589	717	768	879
Plastic Materials	2,843	3,406	4,002	3,968	4,386
Manufactured Goods Classified Mainly by Material	29,600	30,126	35,213	35,567	34,486
Tires and Other Rubber Manufactures	2,040	2,240	3,085	3,478	3,572
Tires and Tubes for Motor Vehicles	1,642	1,515	1,780	1,983	1,961
Paper and Paper Products	1,184	1,407	1,586	1,618	2,001
Textiles (excl. fibers and apparel)	5,445	5,545	5,472	5,471	5,793
Yarn and Thread	1,152	1,118	1,108	1,109	1,117
Woven Fabrics	3,706	3,742	3,598	3,572	3,857
Made-up Articles (excl. clothing)	586	686	767	790	819
Nonmetallic Mineral Manufactures	2,362	2,523	2,936	3,053	3,226
Glass and Glassware	686	803	940	989	996
Tableware	566	556	537	523	529
Steel	12,706	12,610	15,322	14,789	12,509
Bars, Rods, Shapes and Sections	2,076	1,688	2,027	1,983	1,656
Plates, Sheets, Coils and Strip	6,574	7,552	8,883	9,168	7,449
Tubes, Pipes and Fittings	3,399	2,843	4,190	3,400	3,184
Nonferrous Metals	1,564	1,772	2,142	2,246	2,400
Copper and Alloys	721	854	1,083	1,172	1,146
Aluminum and Alloys	606	668	622	635	761
Metal Manufactures	3,913	3,636	4,287	4,542	4,632
Finished Structural Parts and Structures	694	441	331	320	282
Nails and Industrial Fasteners	514	519	720	742	785
Tools	897	958	1,183	1,252	1,231

(continued)

Table 34: Japan's Exports by Commodity, 1986-1990 (continued)

(in millions of dollars, f.o.b. value basis)

	1986	1987	1988	1989	1990
Machinery and Transport Equipment	$133,326	$149,563	$183,765	$192,134	$201,250
Nonelectric Machinery	38,381	44,755	56,048	61,085	63,512
Power Generating Machinery	4,940	5,904	6,738	7,454	7,731
Steam Generating Boilers and Boiler Plants	567	488	235	236	378
Internal Combustion Engines	3,842	4,876	5,939	6,542	6,541
Agricultural Machinery	1,183	1,298	1,006	868	828
Tractors	869	920	696	613	555
Office Machinery	11,305	14,392	18,406	19,278	20,618
Typewriters	574	366	258	181	162
Calculators	556	445	426	427	354
Data Processing Equipment	7,270	9,375	11,393	11,242	12,172
Metalworking Machinery	3,637	3,475	3,927	4,324	4,324
Lathes	676	628	783	940	945
Textile Machinery	1,384	1,852	2,161	2,552	2,951
Sewing Machines	671	861	980	1,084	1,095
Printing and Bookbinding Machinery	616	636	837	1,033	1,123
Construction and Mining Machinery	2,187	2,179	2,400	2,523	2,671
Excavators	1,062	1,191	1,776	1,890	1,970
Heating and Cooling Machinery	1,793	2,032	2,530	2,716	2,805
Pumps and Centrifuges	1,912	2,159	3,876	4,146	4,224
Air and Gas Compressors	740	855	1,520	1,620	1,505
Mechanical Handling Equipment	1,975	1,991	2,583	2,949	3,046
Bearings	806	919	1,217	1,382	1,458
Electric Machinery	35,519	40,883	61,975	64,454	65,925
Electric Power Machinery	2,453	2,724	3,405	3,528	3,652
Generators	490	469	488	539	568
Motors	681	808	1,155	1,172	1,248
Switchboards and Control Panels	810	877	1,066	1,163	1,080
Insulated Wire and Cable	744	693	827	902	947
Telecommunications Equipment	13,644	15,071	*	*	*
Televisions	1,727	1,422	*	*	*
Radios	2,756	2,464	*	*	*
Microphones, Loudspeakers and Amplifiers	1,111	1,169	*	*	*
Household Electric Appliances	1,874	1,713	1,485	1,198	1,136
Batteries	579	729	930	960	1,036
Electronic Tubes and Semiconductors	6,342	8,312	12,327	14,123	13,348
Tubes	1,339	1,795	2,242	2,239	2,169
Discrete Devices	3,185	4,212	1,709	1,798	1,868
Integrated Circuits	n.a.	n.a.	6,603	8,354	7,586
Automotive Electrical Equipment	944	1,146	1,269	1,482	1,547
Electronic Measuring and Controlling Instruments	1,477	1,681	2,322	2,753	2,747
Condensers	654	826	1,131	1,118	1,161
Transport Equipment	59,426	63,925	65,741	66,596	71,814
Railway Equipment	365	624	573	385	352
Road Motor Vehicles	42,676	44,942	48,787	48,469	50,959
Cars	32,945	35,693	38,671	38,804	41,348
Assembled Trucks and Buses	8,022	7,324	9,628	9,124	9,061
Truck and Bus Chassis with Engines	1,633	1,815	350	398	438

(continued)

Table 34: Japan's Exports by Commodity, 1986-1990 (continued)

(in millions of dollars, f.o.b. value basis)

	1986	1987	1988	1989	1990
Road Motor Vehicle Parts	$8,253	$10,714	$9,131	$9,902	$10,850
Motorcycles and Parts	2,686	2,628	2,368	2,458	2,758
Bicycles and Parts	387	402	594	532	852
Ships and Boats	4,879	4,360	3,947	4,428	5,566
Tankers	726	718	769	1,108	1,735
Cargo Ships	2,509	1,805	1,338	1,827	2,461
Miscellaneous Manufactured Goods	31,125	31,599	24,174	24,183	25,893
Clothing	734	665	588	563	564
Scientific, Medical and Optical Instruments	12,408	9,448	10,835	11,181	11,554
Copying Machines	n.a.	n.a.	2,324	2,397	2,434
Cameras Lenses	542	548	508	446	488
Still Cameras	1,601	1,617	1,673	1,721	1,706
Measuring Instruments	845	945	1,195	1,228	1,323
Watches and Clocks	1,963	1,981	2,365	2,156	2,292
Stereo Equipment and Audio and Videocassette Recorders and Players	11,229	10,085	*	*	*
Videocassette Recorders	7,416	5,900	*	*	*
Photographic Supplies	n.a.	n.a.	2,577	2,617	2,788
Film in Rolls	n.a.	n.a.	783	763	823
Phonograph Records and Tapes	2,044	1,969	2,041	1,960	2,254
Musical Instruments	966	1,31	1,341	1,145	1,153
Plastic Products	464	486	556	609	638
Office and Stationery Supplies	528	582	697	706	791
Unclassified Commodities	2,048	2,369	3,591	3,943	4,582
*Addendum:					
Visual Equipment			12,117	11,645	13,058
Televisions			1,779	1,666	2,071
Videocassette Recorders and Players			6,203	6,091	6,395
Television Cameras			4,136	3,888	4,592
Audio Equipment			6,373	6,222	6,472
Radios			2,212	2,181	2,474
Tape Recorders			1,599	1,619	1,451
Compact Disk Players			1,328	1,261	1,294
Microphones, Loudspeakers and Amplifiers			1,235	1,162	1,253
Parts of Audio-Visual Equipment			3,127	3,169	3,282
Telephone and Telegraph Equipment			6,629	6,425	6,035
Facsimile Machines			2,811	2,553	2,002

Source: Ministry of Finance

Table 35: Japan's Imports by Commodity, 1986-1990

(in millions of dollars, c.i.f. value basis)

	1986	1987	1988	1989	1990
Total Imports	$126,408	$149,515	$187,354	$210,847	$234,799
Food and Live Animals	18,246	20,752	26,960	28,130	28,249
Meat and Meat Products	2,587	3,338	4,313	4,899	5,011
Fresh and Frozen Beef	554	800	1,190	1,645	1,885
Fresh and Frozen Pork	1,041	1,417	1,653	1,634	1,671
Fresh and Frozen Poultry	274	322	437	501	553
Dairy Products and Eggs	260	292	499	539	502
Fish and Fish Products	6,426	7,992	10,461	10,033	10,508
Fresh and Frozen Shrimp and Lobster	1,966	2,510	2,848	2,590	2,833
Fresh and Frozen Salmon	571	643	1,070	932	961
Grains and Cereal Products	3,485	3,160	4,241	4,796	4,584
Wheat	886	785	1,034	1,188	1,006
Corn for Mixed Feed	1,158	1,101	1,490	1,603	1,652
Sorghum for Mixed Feed	462	326	422	507	485
Fruits and Vegetables	2,364	2,832	3,706	3,939	3,896
Fruits	1,518	1,757	2,128	2,267	2,225
Vegetables	846	1,075	1,578	1,672	1,671
Sugar	279	290	456	517	519
Coffee	1,130	838	888	891	642
Animal Feeds	671	776	1,225	1,259	1,304
Beverages and Tobacco	941	1,643	2,160	2,882	3,323
Alcoholic Beverages	372	574	855	1,313	1,715
Cigarettes	184	512	751	944	1,036
Crude Materials (excl. fuels)	17,292	21,751	27,633	30,248	28,055
Hides and Skins	563	585	761	696	771
Oilseeds and Oil Nuts	1,568	1,617	2,153	2,124	2,087
Soybeans	1,072	1,087	1,426	1,352	1,259
Rapeseed	303	329	497	514	557
Rubber	578	661	965	833	736
Logs and Lumber	4,044	6,227	7,122	8,201	7,472
Logs	2,923	4,348	4,546	5,055	4,501
Lumber	1,106	1,879	2,576	3,146	2,970
Wood Pulp	1,124	1,441	1,980	2,479	1,922
Textile Fibers and Waste	1,863	2,702	3,309	3,337	2,643
Wool	621	1,017	1,447	1,382	1,019
Cotton	817	1,137	1,318	1,382	1,205
Crude Minerals	943	1,069	1,348	1,615	1,681
Metal Ores, Concentrates and Scrap	5,763	6,120	8,488	9,333	9,119
Iron Ore and Concentrates	2,759	2,618	2,853	3,147	3,374
Nonferrous Ores	2,080	2,404	4,104	4,683	4,342
Copper	1,228	1,476	2,472	2,583	2,441
Zinc	171	197	293	446	517
Nonferrous Scrap	544	773	1,090	1,099	1,068
Aluminum Scrap	341	531	695	686	485

(continued)

Table 35: Japan's Imports by Commodity, 1986-1990 (continued)

(in millions of dollars, c.i.f. value basis)

	1986	1987	1988	1989	1990
Mineral Fuels	$36,904	$39,137	$38,356	$43,053	$56,732
Coal	4,927	4,634	5,375	5,859	6,187
Coking Coal	3,956	3,582	4,127	4,312	4,498
Petroleum and Products	24,117	27,445	25,807	29,823	41,254
Crude Petroleum	19,481	20,663	18,852	21,544	31,584
Petroleum Products	4,636	6,782	6,955	8,279	9,670
Residual Fuel Oil	1,093	1,477	1,165	1,308	1,656
Natural and Manufactured Gas	7,843	7,022	7,128	7,304	9,227
Liquefied Petroleum Gas	2,092	1,970	1,953	1,842	2,540
Liquefied Methane Gas	5,751	5,052	5,170	5,457	6,685
Animal and Vegetable Oils and Fats	245	271	407	423	412
Chemicals	9,733	11,845	14,830	15,949	16,045
Chemical Elements and Compounds	4,566	5,470	6,889	7,180	6,935
Organic Chemicals	2,849	3,494	4,555	4,659	4,457
Inorganic Chemicals	767	869	1,130	1,297	1,194
Dyeing, Tanning and Coloring Materials	420	542	652	680	700
Pharmaceuticals	1,724	2,110	2,658	2,731	2,834
Bulk Antibiotics	374	451	534	524	479
Plastic Materials	981	1,163	1,474	1,641	1,660
Manufactured Goods Classified Mainly by Material	12,390	18,055	27,340	30,767	30,934
Tires and Other Rubber Manufactures	310	437	602	709	745
Wood Manufactures	1,033	1,678	2,071	2,901	2,980
Plywood	n.a.	n.a.	610	1,068	1,031
Wood Chips	679	819	1,069	1,357	1,433
Paper and Paper Products	747	873	1,144	1,258	1,121
Textiles (excl. fibers and apparel)	2,174	2,975	3,929	4,341	4,100
Nonmetallic Mineral Manufactures	1,927	2,847	4,150	4,768	5,375
Glass and Glassware	264	350	496	612	699
Diamonds	939	1,429	2,078	2,232	2,547
Steel	1,762	2,484	4,625	5,069	4,584
Ferroalloys	532	581	1,103	1,256	911
Plates, Sheets, Coils and Strip	429	607	2,201	2,463	2,073
Nonferrous Metals	3,655	5,644	9,312	9,915	9,875
Precious Metals	825	1,414	1,712	1,506	1,736
Copper and Alloys	473	691	1,274	1,698	1,929
Aluminum and Alloys	1,641	2,669	5,030	5,080	4,771
Metal Manufactures	637	882	1,245	1,497	1,762
Machinery and Transport Equipment	13,283	17,264	24,727	29,894	37,867
Nonelectric Machinery	5,318	6,746	9,322	11,467	13,983
Power Generating Machinery	897	1,136	1,292	1,421	1,597
Aircraft Engines	666	813	924	937	1,000
Office Machinery	1,706	2,218	3,279	4,366	5,226
Computers, Peripheral Equipment and Parts	1,671	2,169	3,210	4,286	5,132
Metalworking Machinery	295	277	436	525	670
Heating and Cooling Machinery	222	270	427	513	549

(continued)

Table 35: Japan's Imports by Commodity, 1986-1990 (continued)

(in millions of dollars, c.i.f. value basis)

	1986	1987	1988	1989	1990
Pumps and Centrifuges	$327	$408	$521	$609	$791
Electric Machinery	4,506	5,894	9,289	11,488	12,813
Electric Power Machinery	377	470	731	917	1,083
Electronic Tubes and Semiconductors	1,216	1,531	2,284	2,860	3,310
Integrated Circuits	n.a.	n.a.	1,758	2,254	2,596
Telecommunications Equipment	619	975	*	*	*
Electronic Measuring and Controlling Instruments	762	918	1,530	1,808	1,849
Transport Equipment	3,459	4,624	6,117	6,939	11,072
Cars	1,070	2,031	3,038	4,009	6,189
Automotive Parts	245	340	430	559	775
Aircraft	1,777	1,742	2,024	1,656	3,165
Miscellaneous Manufactured Goods	8,634	13,396	18,702	23,722	27,012
Furniture	431	665	1,033	1,241	1,425
Travel Goods and Handbags	327	514	778	1,035	1,313
Clothing	2,853	4,649	6,702	8,942	8,704
Footwear	490	784	1,108	1,117	1,283
Scientific, Medical and Optical Instruments	952	1,208	1,310	1,593	1,878
Watches and Clocks	330	427	624	889	1,118
Photographic Supplies	431	489	584	521	511
Phonograph Records and Tapes	215	304	471	549	531
Plastic Products	229	341	473	561	651
Toys and Games	176	391	444	472	530
Sporting Goods	374	558	810	1,034	1,201
Art Works and Antiques	411	989	1,712	2,565	4,223
Unclassified Commodities	8,742	5,402	6,240	5,780	6,169
Nonmonetary Gold	6,984	3,467	4,102	3,491	3,575
*Addendum:					
Audio-Visual Equipment and Parts			1,421	1,922	1,759
Telephone and Telegraph Equipment			513	687	857

Source: Ministry of Finance

Table 36: Japan's Dollar-Based Trade with the United States, 1986-1990

(in millions of dollars, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		$80,456	23.3%	$29,054	12.6%	$51,401
1987		83,580	3.9	31,491	8.4	52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1989	January	6,505	11.2	3,533	22.8	2,972
	February	7,571	11.1	3,424	0.0	4,147
	March	8,650	20.3	4,643	22.5	4,008
	April	7,923	7.7	3,368	4.5	4,555
	May	7,140	3.4	4,383	24.9	2,757
	June	7,935	8.0	4,313	15.7	3,622
	July	8,097	1.7	4,236	22.0	3,861
	August	7,340	5.1	4,326	15.8	3,014
	September	8,681	7.0	3,900	12.7	4,781
	October	7,918	-5.2	4,091	15.9	3,828
	November	7,657	-5.0	4,095	12.6	3,563
	December	7,772	-10.6	3,935	7.7	3,837
1990	January	6,206	-4.6	4,016	13.7	2,189
	February	7,131	-5.8	4,174	21.9	2,957
	March	8,325	-3.8	4,563	-1.7	3,761
	April	6,731	-15.0	4,294	27.5	2,438
	May	6,816	-4.5	4,394	0.2	2,422
	June	7,391	-6.9	4,173	-3.2	3,218
	July	7,528	-7.0	4,463	5.4	3,065
	August	7,118	-3.0	4,294	-0.7	2,824
	September	8,286	-4.5	3,972	1.8	4,314
	October	8,466	6.9	4,750	16.1	3,717
	November	8,082	5.5	4,523	10.4	3,559
	December	8,242	6.0	4,753	20.8	3,489

Source: Ministry of Finance

Table 37: Japan's Yen-Based Trade with the United States, 1986-1990

(in billions of yen, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986		Y13,564	-13.0%	Y4,918	-20.9%	Y8,646
1987		12,148	-10.4	4,582	-6.8	7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1989	January	819	10.9	444	22.4	375
	February	973	10.9	440	-0.1	533
	March	1,108	19.7	594	21.9	514
	April	1,047	13.2	445	9.9	602
	May	957	11.0	586	33.9	370
	June	1,136	23.4	617	32.2	519
	July	1,146	9.6	600	31.5	546
	August	1,030	10.8	607	22.0	423
	September	1,260	15.7	566	21.9	694
	October	1,131	2.5	583	24.6	547
	November	1,093	8.2	584	28.1	509
	December	1,119	5.2	566	26.8	553
1990	January	897	9.6	580	30.6	317
	February	1,034	6.3	605	37.5	429
	March	1,240	11.9	678	14.1	561
	April	1,058	1.1	674	51.5	384
	May	1,069	11.8	690	17.7	379
	June	1,127	-0.8	636	3.0	491
	July	1,142	-0.4	678	13.1	463
	August	1,060	2.9	639	5.4	420
	September	1,182	-6.2	568	0.3	614
	October	1,132	0.2	636	9.0	497
	November	1,037	-5.1	580	-0.7	457
	December	1,080	-3.4	622	9.9	458

Source: Ministry of Finance

Table 38: Japan's Foreign Direct Investment by Country, FY 1986-FY 1990

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	Total March 31, 1991
United States	$10,165	$14,704	$21,701	$32,540	$26,128	$130,529
Canada	276	653	626	1,362	1,064	5,656
North America	10,441	15,357	22,328	33,902	27,192	136,185
United Kingdom	984	2,473	3,956	5,239	6,806	22,598
Netherlands	651	829	2,359	4,547	2,744	12,816
Luxembourg	1,092	1,764	657	654	224	5,607
West Germany	210	403	409	1,083	1,242	4,589
France	152	330	463	1,135	1,257	4,156
Switzerland	91	224	454	397	666	2,495
Spain	86	283	161	501	320	1,887
Belgium	50	70	164	326	367	1,720
Europe	3,469	6,576	9,116	14,808	14,294	59,265
Indonesia	250	545	586	631	1,105	11,540
Hong Kong	502	1,072	1,662	1,898	1,785	9,850
Singapore	302	494	747	1,902	840	6,555
Thailand	124	250	859	1,276	1,154	4,422
South Korea	436	647	483	606	284	4,138
Malaysia	158	163	387	673	725	3,231
China	226	1,226	296	438	349	2,823
Taiwan	291	367	372	494	446	2,731
Philippines	21	72	134	202	258	1,580
Asia	2,327	4,868	5,569	8,238	7,054	47,519
Panama	2,401	2,305	1,712	2,044	1,342	16,244
Caymans	930	1,197	2,609	1,658	588	7,332
Brazil	270	229	510	349	615	6,560
Bahamas	792	734	737	620	121	3,459
Mexico	226	28	87	36	168	1,874
Bermuda	16	36	337	228	380	1,578
Latin America	4,737	4,816	6,428	5,238	3,628	40,483
Australia	881	1,222	2,413	4,256	3,669	16,063
Oceania	992	1,413	2,669	4,618	4,166	18,098
Liberia	289	267	648	643	531	4,832
Africa	309	272	653	671	551	5,826
Neutral Zone (Saudi Arabia/Kuwait)	41	54	20	32	26	1,441
Iran	—	—	1	1	—	1,006
Middle East	44	62	259	66	27	3,431
Total	22,320	33,364	47,022	67,540	56,911	310,808

Source: Ministry of Finance

Table 39: Japan's Foreign Direct Investment by Industry, FY 1986-FY 1990

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	Total March 31, 1991
Manufacturing Sector	$3,806	$7,832	$13,805	$16,284	$15,486	$81,613
Food Products	127	328	419	1,300	821	4,085
Textiles	63	206	317	533	796	3,999
Wood and Paper Products	57	317	604	555	314	2,969
Chemicals	355	910	1,292	2,109	2,292	10,940
Metals	328	786	1,367	1,591	1,047	10,308
Nonelectric Machinery	626	687	1,432	1,762	1,454	7,932
Electric Machinery	987	2,421	3,041	4,480	5,684	20,360
Transport Equipment	828	1,473	1,281	2,053	1,872	10,880
Other	435	703	4,051	1,901	1,207	10,138
Nonmanufacturing Sector	17,949	25,080	32,634	50,517	40,620	223,136
Agriculture and Forestry	15	97	162	151	153	1,358
Fisheries	52	44	94	47	61	739
Mining	669	511	1,013	1,262	1,328	16,539
Construction	250	87	309	646	300	2,389
Trade and Sales	1,861	2,269	3,204	5,148	6,156	31,315
Banking, Finance and Insurance	7,240	10,673	13,104	15,395	8,047	65,319
Services	1,560	2,780	3,732	10,616	11,292	34,667
Transportation	1,925	2,145	2,372	2,927	2,169	17,438
Real Estate	3,997	5,428	8,641	14,143	11,107	45,849
Other	379	1,047	3	180	6	7,523
Branch Offices	566	452	584	739	806	5,464
Other Transactions*	---	---	---	---	---	595
Total	22,320	33,364	47,022	67,540	56,911	310,808

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

Table 40: U.S. International Transactions, 1986-1990

(in millions of dollars, IMF value basis)

	1986	1987	1988	1989	1990
Merchandise Trade Balance	$-145,058	$-159,500	$-126,986	$-115,917	$-108,115
Exports	223,367	250,266	320,337	361,451	389,550
Imports	368,425	409,766	447,323	477,368	497,665
Services Balance	15,675	13,973	15,693	25,103	38,321
Military	-4,907	-3,662	-5,743	-6,204	-7,220
Travel	-6,473	-6,656	-4,163	625	1,908
Other Transportation	-2,466	-1,350	319	1,996	2,232
Investment Income	10,969	7,629	5,353	2,688	11,945
Direct Investments	25,521	33,390	36,810	42,484	52,662
Portfolio Investments	-14,552	-25,761	-31,457	-39,796	-40,717
Fees and Royalties	6,192	7,644	8,721	9,776	12,647
Other Services	12,359	10,368	11,204	16,222	16,809
Unilateral Transfers Balance	-16,009	-14,674	-14,943	-15,491	-22,329
Current Account Balance	-145,393	-160,201	-126,236	-106,305	-92,123
Private Capital Flows (net)	95,690	111,394	96,766	103,288	-4,645
Direct Investments (net)	15,412	27,074	41,545	37,163	3,776
Securities (net)	70,507	29,226	38,746	45,963	-25,564
Banking Flows (net)	19,808	46,907	13,913	12,127	15,308
Other Flows (net)	-10,037	8,187	2,562	8,035	1,835
U.S. Government Assets (other than official reserves) (net)	-2,022	1,006	2,966	1,320	2,976
U.S. Official Reserve Assets (net)	312	9,149	-3,912	-25,293	-2,158
Foreign Official Assets (net)	35,588	45,343	39,657	8,624	32,425
Statistical Discrepancy	15,824	-6,690	-9,240	18,366	63,526

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Department of Commerce

Table 41: U.S. Transactions with Japan, 1986-1990

(in millions of dollars, IMF value basis)

	1986	1987	1988	1989	1990
Merchandise Trade Balance	$-54,398	$-56,959	$-52,618	$-49,669	$-41,690
Exports	26,354	27,619	37,183	43,863	47,977
Imports	80,752	84,578	89,801	93,532	89,667
Services Balance	694	-171	2,030	6,957	9,942
Military	-1,830	-1,705	-1,730	-1,362	-1,230
Travel	2,542	2,369	3,054	5,181	5,543
Other Transportation	-727	256	437	1,233	1,273
Investment Income	-1,628	-3,718	-3,168	-2,018	651
Direct Investments	2,378	1,475	1,420	1,433	2,350
Portfolio Investments	-4,005	-5,193	-4,588	-3,451	-1,699
Fees and Royalties	1,066	1,591	2,058	2,096	2,326
Other Services	1,271	1,036	1,379	1,827	1,379
Unilateral Transfers Balance	-87	-93	-110	-132	281
Current Account Balance	-53,792	-57,223	-50,698	-42,844	-31,467
U.S. Government and Private Assets in Japan (net)	-27,145	-17,360	-42,049	-25,100	15,797
Japanese Government and Private Assets in United States (net)	51,253	42,716	86,501	23,057	-26,826
Statistical Discrepancy	29,684	31,867	,246	44,886	42,497

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Department of Commerce

Table 42: U.S. Exports and Imports, 1986-1990*

(in millions of dollars, seasonally unadjusted)

		Exports (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance
1986		$227,159	6.6%	$365,438	5.8%	$-138,279
1987		254,122	11.9	406,241	11.2	-152,119
1988		322,426	26.9	440,952	8.5	-118,526
1989		363,812	12.8	473,211	7.3	-109,399
1990		393,592	8.2	495,311	4.7	-101,718
1989	January	27,541	18.9	36,179	9.5	-8,638
	February	27,927	14.9	36,549	3.0	-8,622
	March	33,243	13.3	40,197	8.7	-6,954
	April	31,052	16.2	38,243	9.4	-7,191
	May	31,496	11.7	40,959	13.4	-9,463
	June	31,820	18.7	40,544	5.2	-8,724
	July	28,708	14.0	39,290	11.0	-10,582
	August	29,406	10.8	40,440	7.7	-11,034
	September	29,710	9.8	38,680	6.5	-8,971
	October	31,756	11.3	43,536	12.2	-11,780
	November	30,279	9.8	41,033	6.9	-10,754
	December	30,874	6.5	37,561	-4.6	-6,687
1990	January	30,664	11.3	40,304	11.4	-9,640
	February	30,962	10.9	37,112	1.5	-6,150
	March	35,971	8.2	42,339	5.3	-6,369
	April	32,617	5.0	39,144	2.4	-6,527
	May	33,539	6.5	40,846	-0.3	-7,308
	June	34,470	8.3	40,946	1.0	-6,476
	July	30,736	7.1	41,495	5.6	-10,759
	August	31,723	7.9	42,232	4.4	-10,509
	September	31,444	5.8	40,602	5.0	-9,157
	October	35,310	11.2	47,395	8.9	-12,085
	November	33,267	9.9	43,796	6.7	-10,529
	December	32,889	6.5	39,100	4.1	-6,211

*The export and import data reflect revisions not necessarily incorporated in other tables. The export statistics cover domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 43: U.S. Exports by Major Market, 1986-1990

(in millions of dollars, f.a.s. value basis)

	1986	1987	1988	1989	1990
Total Exports	$227,159	$254,122	$322,426	$363,812	$393,592
Developed Countries	151,626	165,375	206,805	234,575	256,725
Japan	26,882	28,249	37,725	44,494	48,580
Canada	55,512	59,814	71,622	78,809	83,674
Western Europe	61,642	69,718	87,858	100,165	113,067
United Kingdom	11,418	14,114	18,364	20,837	23,490
West Germany	10,561	11,748	14,348	16,862	18,760
France	7,216	7,943	9,970	11,579	13,665
Netherlands	7,848	8,217	10,117	11,364	13,022
Belgium-Luxembourg	5,399	6,189	7,411	8,522	10,451
Italy	4,838	5,530	6,775	7,215	7,992
Spain	2,615	3,148	4,215	4,796	5,213
Ireland	1,434	1,810	2,183	2,483	2,540
European Community	53,154	60,575	75,755	86,331	98,129
Switzerland	2,977	3,151	4,196	4,911	4,943
Sweden	1,871	1,894	2,700	3,139	3,405
Turkey	1,160	1,483	1,850	2,003	2,243
Norway	937	842	929	1,037	1,281
Australia	5,551	5,495	6,973	8,331	8,538
South Africa	1,158	1,281	1,688	1,659	1,732
Developing Countries	70,637	81,691	106,727	117,769	127,328
Latin America	27,968	31,574	40,024	44,396	49,284
Mexico	12,392	14,582	20,628	24,982	28,279
Brazil	3,885	4,040	4,267	4,804	5,048
Venezuela	3,141	3,586	4,612	3,025	3,108
Colombia	1,319	1,412	1,754	1,924	2,029
Dominican Republic	921	1,142	1,359	1,645	1,656
East Asian Newly Industrialized Countries	18,290	23,547	34,816	38,429	40,734
South Korea	6,355	8,099	11,232	13,459	14,404
Taiwan	5,524	7,413	12,129	11,335	11,491
Singapore	3,380	4,053	5,768	7,345	8,023
Hong Kong	3,030	3,983	5,687	6,291	6,817
Other Developing Countries	24,379	26,570	31,887	34,944	37,310
Malaysia	1,730	1,897	2,142	2,871	3,425
Thailand	936	1,544	1,962	2,288	2,995
India	1,536	1,463	2,500	2,458	2,486
Philippines	1,363	1,599	1,878	2,202	2,471
Indonesia	946	767	1,059	1,247	1,897
Saudi Arabia	3,449	3,373	3,776	3,574	4,049
Israel	2,239	3,130	3,244	2,827	3,203
Algeria	453	426	730	756	951
Iraq	528	683	1,157	1,169	732
Nigeria	409	295	357	490	553
Eastern Europe and Communist Countries	5,127	5,723	8,686	11,073	9,018
China	3,106	3,497	5,021	5,755	4,806
Soviet Union	1,248	1,480	2,769	4,285	3,087

Source: Department of Commerce

Table 44: U.S. Imports by Major Supplier, 1986-1990

(in millions of dollars, Customs value basis)

	1986	1987	1988	1989	1990
Total Imports	$365,438	$406,241	$440,952	$473,211	$495,311
Developed Countries	245,956	256,553	277,575	289,882	297,444
Japan	81,911	84,575	89,519	93,553	89,684
Canada	68,253	71,085	81,398	87,953	91,380
Western Europe	89,825	95,496	100,443	101,764	109,039
United Kingdom	15,396	17,341	17,976	18,319	20,188
West Germany	25,124	27,069	26,362	24,833	28,162
France	10,129	10,730	12,509	13,014	13,153
Netherlands	4,066	3,964	4,559	4,810	4,952
Belgium-Luxembourg	4,006	4,171	4,493	4,555	4,585
Italy	10,607	11,040	11,576	11,933	12,751
Spain	2,702	2,839	3,204	3,317	3,311
Ireland	1,003	1,112	1,375	1,566	1,755
European Community	75,736	81,188	84,939	85,153	91,877
Switzerland	5,253	4,249	4,611	4,714	5,587
Sweden	4,420	4,758	4,985	4,892	4,937
Turkey	633	821	979	1,372	1,183
Norway	1,079	1,404	1,446	1,991	1,830
Australia	2,632	3,007	3,541	3,873	4,447
South Africa	2,365	1,346	1,513	1,531	1,698
Developing Countries	117,231	141,129	152,702	169,273	180,445
Latin America	39,541	44,371	48,789	54,816	61,035
Mexico	17,302	20,271	23,260	27,162	30,157
Brazil	6,813	7,865	9,294	8,410	7,898
Venezuela	5,097	5,579	5,157	6,771	9,480
Colombia	1,874	2,232	2,161	2,555	3,168
Dominican Republic	1,085	1,163	1,410	1,646	1,752
East Asian Newly Industrialized Countries	46,136	57,664	63,060	62,774	60,573
South Korea	12,729	16,987	20,105	19,737	18,485
Taiwan	19,791	24,622	24,714	24,313	22,666
Singapore	4,725	6,201	7,973	9,003	9,800
Hong Kong	8,891	9,854	10,238	9,722	9,622
Other Developing Countries	31,554	39,094	40,853	51,683	58,837
Malaysia	2,421	2,921	3,692	4,744	5,272
Thailand	1,748	2,220	3,210	4,380	5,289
India	2,283	2,529	2,940	3,315	3,197
Philippines	1,972	2,264	2,666	3,068	3,384
Indonesia	3,312	3,394	3,150	3,529	3,341
Saudi Arabia	3,612	4,433	5,620	7,157	10,021
Israel	2,418	2,639	2,972	3,239	3,313
Algeria	1,831	1,999	1,814	1,829	2,626
Iraq	440	495	1,488	2,415	3,008
Nigeria	2,530	3,573	3,279	5,284	5,982
Eastern Europe and Communist Countries	6,774	8,219	10,675	14,056	17,422
China	4,771	6,293	8,511	11,990	15,237
Soviet Union	558	425	586	709	1,059

Source: Department of Commerce

Table 45: U.S. Trade Balance with Major Trading Partners, 1986-1990

(in millions of dollars; exports f.a.s., imports Customs)

	1986	1987	1988	1989	1990
Overall Trade Balance	$-138,279	$-152,119	$-118,526	$-109,399	$-101,718
Developed Countries	-94,330	-91,178	-70,770	-55,306	-40,719
Japan	-55,030	-56,326	-51,794	-49,059	-41,105
Canada	-12,741	-11,271	-9,776	-9,144	-7,707
Western Europe	-28,183	-25,778	-12,585	-1,599	4,029
United Kingdom	-3,978	-3,227	388	2,518	3,302
West Germany	-14,563	-15,322	-12,014	-7,970	-9,402
France	-2,913	-2,787	-2,539	-1,435	511
Netherlands	3,782	4,253	5,558	6,554	8,070
Belgium-Luxembourg	1,393	2,019	2,917	3,967	5,866
Italy	-5,769	-5,510	-4,801	-4,718	-4,760
Spain	-87	310	1,012	1,479	1,901
Ireland	431	699	809	917	784
European Community	-22,582	-20,613	-9,183	1,178	6,252
Switzerland	-2,276	-1,098	-415	197	-645
Sweden	-2,549	-2,865	-2,285	-1,753	-1,533
Turkey	526	661	871	632	1,061
Norway	-142	-562	-517	-955	-549
Australia	2,920	2,488	3,432	4,458	4,091
South Africa	-1,206	-64	175	128	34
Developing Countries	-46,595	-59,438	-45,976	-51,505	-53,117
Latin America	-11,573	-12,797	-8,764	-10,420	-11,751
Mexico	-4,910	-5,689	-2,631	-2,180	-1,878
Brazil	-2,928	-3,825	-5,028	-3,606	-2,850
Venezuela	-1,956	-1,993	-546	-3,745	-6,371
Colombia	-555	-821	-406	-631	-1,139
Dominican Republic	-164	-21	-50	-1	-96
East Asian Newly Industrialized Countries	-27,846	-34,117	-28,214	-24,345	-19,839
South Korea	-6,374	-8,888	-8,873	-6,278	-4,081
Taiwan	-14,267	-17,209	-12,585	-12,978	-11,175
Singapore	-1,345	-2,148	-2,206	-1,659	-1,778
Hong Kong	-5,861	-5,871	-4,550	-3,431	-2,805
Other Developing Countries	-7,175	-12,524	-8,966	-16,739	-21,527
Malaysia	-691	-1,025	-1,550	-1,874	-1,847
Thailand	-811	-676	-1,248	-2,091	-2,293
India	-747	-1,065	-439	-857	-711
Philippines	-609	-665	-788	-866	-913
Indonesia	-2,366	-2,627	-2,092	-2,282	-1,444
Saudi Arabia	-163	-1,060	-1,844	-3,583	-5,971
Israel	-179	491	273	-412	-110
Algeria	-1,378	-1,572	-1,084	-1,074	-1,674
Iraq	87	189	-331	-1,246	-2,276
Nigeria	-2,122	-3,278	-2,922	-4,794	-5,429
Eastern Europe and Communist Countries	-1,647	-2,496	-1,989	-2,938	-8,404
China	-1,665	-2,796	-3,490	-6,235	-10,431
Soviet Union	689	1,055	2,183	3,574	2,028

Source: Department of Commerce

Table 46: U.S. Exports by End-Use Category, 1986-1990

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Total Exports	$216,235	$253,906	$322,498	$362,808	$393,592
Food, Feed and Beverages	22,840	24,737	32,856	35,504	34,976
Wheat	3,287	3,272	5,104	6,125	4,017
Corn	2,660	3,255	5,101	6,824	6,274
Sorghum, Barley and Oats	502	640	845	1,165	1,024
Other Animal Feeds	2,623	2,698	3,428	2,906	2,659
Soybeans	4,299	4,305	4,884	4,027	3,572
Meat and Meat Products	1,502	1,861	2,635	2,957	3,339
Fish and Fish Products	1,315	1,637	2,211	2,359	2,936
Fruits and Fruit Products	1,406	1,634	1,922	2,027	2,812
Vegetables and Vegetable Products	807	609	1,028	1,176	1,806
Industrial Supplies and Materials	61,894	67,842	86,732	94,388	105,075
Raw Cotton	834	1,655	1,979	2,261	2,800
Unmanufactured Tobacco	1,220	1,107	1,262	1,338	1,462
Hides and Skins (incl. furskins)	1,529	1,752	1,850	1,742	1,762
Metallurgical-Grade Coal	2,654	2,264	2,735	3,006	3,046
Other Coal	1,384	1,171	1,363	1,782	2,017
Fuel Oil	1,907	1,961	1,684	1,774	2,502
Other Petroleum Products	2,071	2,316	2,396	3,218	4,510
Nuclear Fuel Materials and Fuels	1,166	907	747	1,326	1,117
Logs, Lumber, Plywood and Veneers	2,503	3,342	4,510	4,973	5,235
Paper Base Stocks	2,347	3,109	4,017	4,355	4,115
Newsprint and Other Paper Products	2,390	2,905	3,490	3,710	4,363
Synthetic Fibers, Yarn and Fabric	1,577	1,823	2,288	2,302	2,745
Plastic Materials	3,884	4,993	6,617	5,784	6,504
Fertilizers, Pesticides and Insecticides	3,686	3,883	4,345	4,145	3,950
Industrial Inorganic Chemicals	1,347	1,585	2,026	3,069	2,819
Industrial Organic Chemicals	4,786	5,921	7,610	9,023	8,798
Iron Ore, Steel Scrap and Ferroalloys	1,328	1,244	1,685	2,092	2,119
Steel Slabs, Bars, Wire Rods, Plates and Sheets	512	640	1,200	2,208	2,146
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	700	779	1,019	1,628	1,607
Aluminum	1,172	1,695	2,925	3,260	3,201
Copper	611	655	1,353	1,158	1,830
Nonmonetary Gold	5,191	1,881	5,170	1,886	2,994
Other Nonferrous Metals	893	1,159	1,552	1,946	1,949
Fabricated Metal Products	1,743	2,183	2,754	2,713	3,251
Manufactured Mineral Supplies	725	846	980	1,397	1,647
Blank Audio and Video Tapes and Other Media	624	838	1,245	1,386	1,799
Capital Goods	79,465	90,657	115,417	132,368	152,675
Electric Machinery	7,050	8,382	10,827	10,584	12,747
Generators, Transformers and Accessories	1,432	1,621	2,105	1,788	2,121
Other Electric Apparatus and Parts	5,618	6,760	8,721	8,797	10,626
Nonelectric Machinery	55,534	64,447	81,899	93,689	105,939
Drilling and Oilfield Equipment	2,550	1,845	2,408	2,866	3,158
Excavating, Paving and Construction Machinery	1,416	1,515	1,980	2,963	3,569
Nonfarm Tractors and Parts	988	1,007	1,366	1,607	1,126

(continued)

Table 46: U.S. Exports by End-Use Category, 1986-1990 (continued)

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Industrial Engines, Pumps, Compressors and Generators	$2,863	$3,008	$3,805	$5,662	$6,425
Food and Tobacco Processing Machinery	446	563	685	1,088	1,253
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	1,915	2,125	2,544	2,867	3,144
Textile and Sewing Machinery	453	556	705	1,139	1,038
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	959	1,140	1,473	1,327	1,486
Pulp, Paper, Printing and Packaging Machinery	1,046	1,278	1,682	1,828	2,266
Measuring, Testing and Control Instruments	3,936	4,366	5,282	4,640	5,776
Materials Handling Equipment	1,009	1,159	1,538	1,949	2,400
Photo and Service Industry Machinery	1,576	1,877	2,380	3,229	3,564
Agricultural Machinery and Equipment	1,707	1,914	2,377	2,100	2,375
Computers	3,518	4,240	5,372	7,355	7,973
Computer Peripherals, Accessories and Parts	11,656	14,279	18,059	16,161	17,950
Semiconductors	4,799	6,399	8,749	11,807	13,333
Telecommunications Equipment	4,309	5,017	6,337	7,927	9,365
Other Office and Business Machines	1,259	1,612	1,724	2,157	2,141
Scientific, Hospital and Medical Equipment	3,591	4,158	5,248	6,556	7,635
Transportation Equipment	16,881	17,828	22,691	28,095	33,989
Civilian Aircraft	7,381	7,657	10,431	13,588	18,444
Parts for Civilian Aircraft	4,472	4,776	5,588	6,787	7,603
Engines for Civilian Aircraft	3,307	3,772	4,865	6,137	6,255
Marine Engines and Parts	1,008	1,180	1,232	775	736
Automotive Vehicles, Parts and Engines	22,161	25,739	30,208	30,437	37,395
Cars	6,339	7,359	9,014	10,037	10,945
Trucks, Buses and Special Vehicles	3,096	3,771	3,986	3,619	4,335
Automotive Engines and Parts	2,655	2,834	3,346	3,171	4,255
Other Automotive Parts and Accessories (incl. tires)	10,072	11,776	13,863	13,611	17,859
Consumer Goods	15,856	19,758	26,000	34,084	42,762
Manufactured Consumer Nondurables	8,701	10,531	13,138	15,637	19,688
Textile Apparel, Footwear and Household Goods	1,032	1,303	1,682	2,134	2,636
Pharmaceutical Preparations	3,251	3,450	4,244	4,338	4,837
Printed Material	1,298	1,532	1,873	2,172	2,870
Toiletries and Cosmetics	352	424	522	814	1,143
Cigarettes and Other Tobacco Manufactures	1,520	2,319	2,926	3,633	5,042
Manufactured Consumer Durables	6,208	8,068	11,352	16,773	21,077
Household and Kitchen Appliances	716	1,003	1,476	2,281	2,617
Pleasure Boats and Motors	432	604	877	1,038	1,189
Toys, Sporting Goods, Bicycles and Motorcycles	700	946	1,367	2,204	2,877
Records, Tapes and Disks	421	547	793	1,148	1,902
Artwork and Antiques	894	1,247	1,876	3,777	4,600
Unmanufactured Consumer Goods	947	1,159	1,511	1,674	1,997
Gemstones	884	1,090	1,425	1,567	1,797
Other Exports	14,019	25,173	31,286	36,028	20,709

Source: Department of Commerce

Table 47: U.S. Imports by End-Use Category, 1986-1990

(in millions of dollars, Customs value)

	1986	1987	1988	1989	1990
Total Imports	$365,672	$406,283	$441,926	$472,761	$495,311
Food, Feed and Beverages	24,403	24,809	24,930	25,056	26,649
Coffee	4,263	2,710	2,284	2,273	1,766
Meat and Meat Products	2,819	3,306	3,475	3,310	4,019
Fish and Fish Products	4,746	5,591	5,422	5,400	5,207
Fruits and Fruit Products	2,484	2,843	3,089	2,902	3,387
Vegetables and Vegetable Products	1,241	1,197	1,232	1,619	1,932
Wine	1,759	1,916	1,906	1,796	1,865
Other Alcoholic Beverages	1,247	1,356	1,504	1,585	1,725
Industrial Supplies and Materials	101,371	110,665	118,064	132,214	143,207
Crude Oil	22,059	29,453	25,805	35,500	43,785
Fuel Oil	5,115	5,989	5,945	6,449	8,027
Other Petroleum Products	5,287	5,610	5,777	6,248	7,089
Liquefied Petroleum Gas	1,885	1,930	1,888	2,186	3,219
Natural Gas	1,873	1,715	1,876	1,852	2,335
Logs and Lumber	2,997	3,133	3,030	3,071	1,634
Paper Base Stocks	1,659	2,131	2,734	3,062	2,868
Newsprint	3,667	4,121	4,512	4,545	4,324
Other Paper and Paper Products	2,056	2,417	2,965	2,013	2,280
Cotton Fibers, Yarn and Fabric	1,193	1,554	1,218	1,259	1,296
Synthetic Fibers, Yarn and Fabric	1,893	1,920	1,977	1,971	2,111
Plastic Materials	1,756	2,023	2,414	2,733	3,117
Fertilizers, Pesticides and Insecticides	1,688	1,613	2,140	1,881	1,846
Industrial Inorganic Chemicals	975	1,071	1,293	1,780	1,950
Industrial Organic Chemicals	3,293	3,627	4,738	4,726	5,098
Iron Ore, Steel Scrap and Ferroalloys	1,193	1,277	1,921	1,966	1,793
Steel Slabs, Bars, Wire Rods, Plates and Sheets	5,193	5,635	6,343	6,331	6,015
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	3,217	3,398	4,067	3,279	2,879
Fabricated Steel Products	1,564	1,789	2,177	2,365	2,421
Bauxite and Aluminum	2,654	2,981	3,669	3,858	3,547
Copper	820	1,002	1,522	1,575	1,423
Nickel	686	763	1,463	1,607	1,154
Nonmonetary Gold	5,696	1,651	1,285	1,511	1,104
Other Precious Metals	2,159	1,889	2,026	2,158	2,520
Fabricated Nonferrous Metal Products	2,626	2,828	3,609	3,406	3,459
Capital Goods	71,863	84,769	101,787	113,134	116,546
Electric Machinery	8,046	9,518	11,540	11,422	12,781
Generators, Transformers and Accessories	2,317	2,740	3,581	2,365	2,600
Other Electric Apparatus and Parts	5,731	6,778	7,959	9,057	10,181
Nonelectric Machinery	56,979	67,890	82,002	90,878	91,951
Excavating, Paving and Construction Machinery	1,364	1,539	1,668	1,965	1,851
Industrial Engines, Pumps, Compressors and Generators	2,682	3,215	3,963	4,374	4,512
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	3,440	3,320	3,687	4,129	4,050
Textile and Sewing Machinery	1,006	1,380	1,657	1,853	1,813
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	1,433	1,708	2,052	2,391	2,301

(continued)

Table 47: U.S. Imports by End-Use Category, 1986-1990 (continued)

(in millions of dollars, Customs value)

	1986	1987	1988	1989	1990
Pulp, Paper, Printing and Packaging Machinery	$2,087	$2,211	$2,468	$2,767	$2,585
Measuring, Testing and Control Instruments	2,032	2,471	2,944	2,660	2,608
Materials Handling Equipment	1,892	1,811	1,922	2,338	2,041
Photo and Service Industry Machinery	2,252	2,674	2,772	3,392	3,149
Agricultural Machinery and Equipment	1,857	2,153	2,519	2,672	2,993
Computers	1,874	2,258	2,994	3,365	2,949
Computer Peripherals, Accessories and Parts	9,146	12,581	15,334	18,179	20,045
Semiconductors	5,947	7,783	10,963	12,327	12,168
Telecommunications Equipment	6,924	8,129	9,407	10,446	9,366
Other Office and Business Machines	3,314	3,605	4,134	4,286	4,149
Scieutific, Hospital and Medical Equipment	2,662	2,951	3,406	3,974	5,029
Transportation Equipment	6,836	7,361	8,245	10,834	11,814
Civilian Aircraft	1,903	2,080	2,713	2,913	2,691
Parts for Civilian Aircraft	2,027	2,249	2,515	2,650	3,156
Engines for Civilian Aircraft	2,156	2,248	2,344	3,967	4,820
Automotive Vehicles, Parts and Engines	78,252	85,174	87,948	85,998	87,120
Cars	45,292	47,923	47,053	44,477	45,870
Trucks, Buses and Special Vehicles	9,134	9,150	8,317	9,417	9,025
Bodies and Chassis for Trucks and Buses	1,296	1,593	2,030	1,102	481
Automotive Engines and Engine Parts	4,635	5,416	6,536	7,716	6,647
Automotive Tires and Tubes	1,651	1,928	2,067	2,433	2,253
Other Automotive Parts and Accessories	16,244	19,164	21,945	20,853	22,845
Consumer Goods	79,427	88,824	96,424	102,812	105,699
Manufactured Consumer Nondurables	33,393	39,432	43,117	46,467	49,176
Cotton Apparel and Household Goods	6,186	8,078	8,383	9,408	10,244
Wool Apparel and Household Goods	1,615	1,595	1,668	1,567	1,489
Other Textile Apparel and Household Goods	9,648	10,619	10,723	11,970	12,147
Nontextile Apparel and Household Goods	2,386	3,131	3,805	3,807	3,672
Footwear	4,877	5,558	5,904	5,972	6,624
Sporting and Camping Apparel, Footwear and Gear	1,719	2,063	2,567	3,291	4,134
Pharmaceutical Preparations	2,223	2,703	3,497	3,467	3,672
Printed Material	1,293	1,393	1,495	1,506	1,545
Manufactured Consumer Durables	41,484	44,894	47,763	50,326	50,829
Furniture and Household Items	3,675	4,423	4,606	3,883	4,043
Glassware and Chinaware	1,696	1,940	2,006	1,276	1,306
Cookware, Cutlery, House and Garden Wares and Tools	1,642	1,890	2,087	1,894	1,880
Household and Kitchen Appliances	2,249	3,352	3,638	3,385	3,900
Toys and Sporting Goods (incl. bicycles)	5,778	7,196	7,985	8,946	9,741
Photographic and Optical Equipment	1,412	1,539	1,479	1,390	1,281
Television Sets and Other Video Equipment	8,094	6,410	5,824	6,848	6,404
Radios, Stereo Equipment and Other Audio Equipment	3,907	4,551	5,413	6,438	5,014
Jewelry and Watches	3,723	4,188	4,533	3,516	4,484
Artworks and Antiques	1,687	1,582	1,768	2,841	2,997
Unmanufactured Consumer Goods	4,550	4,499	5,544	6,019	5,693
Gem Diamonds	3,463	3,428	4,296	4,363	3,975
Other Imports	10,357	12,042	12,775	13,548	16,089

Source: Department of Commerce

Table 48: U.S. Trade with Japan, 1986-1990*

(in millions of dollars, seasonally unadjusted)

		Exports (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance
1986		$26,882	18.8%	$81,911	19.1%	$-55,030
1987		28,249	5.1	84,575	3.3	-56,326
1988		37,725	33.5	89,519	5.8	-51,794
1989		44,494	17.9	93,553	4.5	-49,059
1990		48,580	9.2	89,684	-4.1	-41,105
1989	January	3,125	15.1	6,733	5.9	-3,608
	February	3,258	10.1	7,763	9.4	-4,506
	March	4,104	28.5	8,440	13.9	-4,335
	April	3,677	20.7	7,537	4.0	-3,860
	May	3,610	21.9	7,927	18.6	-4,317
	June	4,073	21.4	7,871	4.2	-3,798
	July	3,866	17.8	7,855	7.2	-3,990
	August	3,917	18.8	7,859	2.4	-3,942
	September	3,502	12.6	7,743	9.7	-4,241
	October	3,699	13.5	8,603	1.9	-4,904
	November	3,759	16.2	7,774	-5.1	-4,014
	December	3,904	17.7	7,449	-12.1	-3,545
1990	January	4,028	28.9	6,878	2.2	-2,850
	February	3,784	16.1	6,911	-11.0	-3,128
	March	4,236	3.2	7,808	-7.5	-3,571
	April	3,598	-2.2	7,641	1.4	-4,043
	May	3,676	1.8	6,751	-14.8	-3,076
	June	4,178	2.6	7,220	-8.3	-3,043
	July	4,208	8.9	7,251	-7.7	-3,043
	August	3,889	-0.7	7,629	-2.9	-3,741
	September	4,000	14.2	7,023	-9.3	-3,023
	October	4,279	15.7	8,721	1.4	-4,442
	November	4,395	16.9	8,106	4.3	-3,711
	December	4,310	10.4	7,745	4.0	-3,435

*The export and import data reflect revisions not necessarily incorporated in Table 49 and Table 50. The export statistics cover domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 49: U.S. Exports to Japan by End-Use Category, 1986-1990

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Total Exports to Japan	$26,797	$28,284	$37,732	$44,479	$48,580
Food, Feed and Beverages	5,078	5,614	8,005	8,481	8,505
Wheat	425	350	426	477	421
Corn	868	1,024	1,611	1,595	1,673
Sorghum, Barley and Oats	182	181	233	351	316
Other Animal Feeds	231	228	326	327	286
Soybeans	837	782	1,033	866	818
Other Oilseeds	44	39	58	56	65
Meat and Meat Products	765	910	1,379	1,634	1,578
Dairy Products and Eggs	47	45	56	36	45
Fish and Fish Products	867	1,070	1,582	1,622	1,802
Fruits and Fruit Products	372	449	535	580	543
Vegetables and Vegetable Products	155	190	267	277	290
Nuts and Nut Products	125	105	122	125	116
Bakery and Confectionery Products	31	46	86	87	79
Wine	13	25	41	57	81
Other Alcoholic Beverages	23	49	105	110	130
Industrial Supplies and Materials	11,982	10,386	13,157	15,546	15,232
Raw Cotton	251	423	482	547	579
Unmanufactured Tobacco	230	302	213	297	305
Hides and Skins (incl. furskins)	336	380	467	408	457
Metallurgical-Grade Coal	534	443	525	503	510
Other Coal	35	43	77	452	463
Fuel Oil	391	409	349	236	164
Other Petroleum Products	211	337	404	515	594
Natural Gas	187	149	154	158	162
Nuclear Fuel Materials and Fuels	600	526	476	790	662
Logs, Lumber, Plywood and Veneers	1,110	1,584	1,928	2,392	2,312
Manufactured Wood Supplies	15	29	46	81	109
Paper Base Stocks	576	760	1,057	993	778
Newsprint and Other Paper Products	346	389	459	513	489
Cotton and Other Natural Fibers, Yarn and Fabric	10	29	42	65	51
Synthetic Fibers, Yarn and Fabric	49	59	91	93	107
Synthetic Rubber	69	70	80	52	51
Plastic Materials	305	385	498	446	450
Fertilizers, Pesticides and Insecticides	256	298	295	267	274
Industrial Inorganic Chemicals	144	167	232	281	247
Industrial Organic Chemicals	580	689	908	998	987
Iron Ore, Steel Scrap and Ferroalloys	167	125	163	158	164
Steel Slabs, Bars, Wire Rods, Plates and Sheets	25	18	92	224	145
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	36	36	57	187	67
Aluminum	406	662	1,180	1,504	1,331
Copper	191	192	377	424	639
Nonmonetary Gold	3,340	14	99	78	19
Other Precious Metals	77	115	195	130	199
Other Nonferrous Metals	180	202	318	298	318
Fabricated Metal Products	97	126	165	176	155

(continued)

Table 49: U.S. Exports to Japan by End-Use Category, 1986-1990 (continued)

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Unmanufactured Nonmetallic Minerals	$126	$148	$178	$111	$117
Manufactured Mineral Supplies	77	91	105	290	319
Blank Audio and Video Tapes and Other Media	74	94	142	131	141
Capital Goods	6,682	7,762	10,716	12,152	14,438
Electric Machinery	454	513	681	730	712
Generators, Transformers and Accessories	58	64	95	96	144
Other Electric Apparatus and Parts	396	449	587	634	567
Nonelectric Machinery	4,329	5,277	7,667	9,605	10,358
Excavating, Paving and Construction Machinery	34	40	69	127	143
Nonfarm Tractors and Parts	59	67	110	99	105
Industrial Engines, Pumps, Compressors and Generators	111	129	166	267	303
Food and Tobacco Processing Machinery	26	35	41	75	75
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	166	145	216	231	240
Textile and Sewing Machinery	22	25	41	69	56
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	46	46	70	58	76
Pulp, Paper, Printing and Packaging Machinery	77	81	124	122	134
Measuring, Testing and Control Instruments	481	580	842	656	739
Materials Handling Equipment	25	31	59	72	93
Photo and Service Industry Machinery	125	159	198	291	298
Agricultural Machinery and Equipment	24	33	47	70	81
Computers	407	504	803	1,246	1,320
Computer Peripherals, Accessories and Parts	1,005	1,225	1,743	1,859	2,245
Semiconductors	360	550	841	1,171	1,297
Telecommunications Equipment	326	456	621	978	974
Other Office and Business Machines	101	124	102	192	148
Scientific, Hospital and Medical Equipment	446	578	775	716	1,113
Transportation Equipment	1,899	1,971	2,368	1,818	3,368
Civilian Aircraft	1,163	1,100	1,306	720	2,178
Parts for Civilian Aircraft	380	456	523	608	675
Engines for Civilian Aircraft	272	311	430	374	420
Marine Engines and Parts	61	93	92	71	65
Automotive Vehicles, Parts and Engines	302	406	826	1,123	1,760
Cars	56	111	348	481	869
Trucks, Buses and Special Vehicles	19	20	46	66	127
Automotive Tires and Tubes	21	62	147	178	180
Automotive Parts and Accessories (incl. engines)	206	213	285	397	584
Consumer Goods	1,821	2,788	3,701	5,571	6,897
Manufactured Consumer Nondurables	1,087	1,630	2,010	2,417	2,972
Textile Apparel, Footwear and Household Goods	39	76	136	183	270
Nontextile Apparel, Footwear and Household Goods	40	61	77	109	98
Sporting and Camping Apparel, Footwear and Gear	32	59	60	27	43
Pharmaceutical Preparations	639	701	849	870	805
Printed Material	62	77	105	137	146

(continued)

Table 49: U.S. Exports to Japan by End-Use Category, 1986-1990 (continued)

(in millions of dollars, f.a.s. value)

	1986	1987	1988	1989	1990
Toiletries and Cosmetics	$32	$49	$40	$66	$82
Cigarettes and Other Tobacco Manufactures	131	495	614	874	1,315
Manufactured Consumer Durables	624	996	1,460	2,927	3,618
Furniture	19	23	37	54	56
Cookware, Cutlery, House and Garden Wares and Tools	41	56	39	59	53
Household and Kitchen Appliances	25	29	35	94	93
Floor Coverings	9	21	37	61	52
Pleasure Boats and Motors	16	31	56	97	177
Toys, Sporting Goods, Bicycles and Motorcycles	101	185	286	465	473
Musical Instruments and Photographic and Optical Equipment	41	60	75	104	98
Television Sets and Other Video Equipment	14	14	30	64	57
Radios, Stereo Equipment and Other Audio Equipment	8	7	16	62	65
Records, Tapes and Disks	44	70	121	220	261
Jewelry and Watches	45	67	89	153	229
Artwork and Antiques	162	310	499	1,258	1,746
Unmanufactured Consumer Goods	111	163	231	227	308
Gemstones	107	158	226	220	300
Other Exports	931	1,329	1,326	1,606	1,748

Source: Department of Commerce

Table 50: U.S. Imports from Japan by End-Use Category, 1986-1990

(in millions of dollars, Customs value)

	1986	1987	1988	1989	1990
Total Imports from Japan	$80,722	$84,592	$89,762	$93,482	$89,684
Food, Feed and Beverages	509	465	406	348	327
Fish and Fish Products	313	265	200	176	151
Industrial Supplies and Materials	7,549	7,987	8,495	8,563	8,397
Paper and Paper Products	122	155	174	183	186
Cotton Fibers, Yarn and Fabric	165	155	124	119	115
Synthetic Fibers, Yarn and Fabric	514	462	406	358	323
Plastic Materials	424	514	509	564	593
Fertilizers, Pesticides and Insecticides	20	22	27	53	65
Industrial Inorganic Chemicals	107	147	144	173	184
Industrial Organic Chemicals	560	652	720	688	629
Steel Slabs, Bars, Wire Rods, Plates and Sheets	1,433	1,524	1,584	1,674	1,457
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	710	712	841	685	571
Fabricated Steel Products	500	518	590	575	563
Fabricated Nonferrous Metal Products	564	513	444	415	559
Blank Audio and Video Tapes and Other Media	833	809	752	671	723
Capital Goods	23,441	27,697	32,834	36,872	34,567
Electric Machinery	2,337	2,853	3,468	3,122	3,277
Generators, Transformers and Accessories	569	634	807	411	451
Other Electric Apparatus and Parts	1,768	2,219	2,661	2,711	2,825
Nonelectric Machinery	20,736	24,324	28,810	32,973	30,549
Drilling and Oilfield Equipment	346	137	373	251	244
Specialized Mining and Oil Processing Equipment	382	525	563	478	517
Excavating, Paving and Construction Machinery	321	414	436	433	480
Nonfarm Tractors and Parts	20	83	105	269	272
Industrial Engines, Pumps, Compressors and Generators	638	905	1,140	1,163	1,212
Food and Tobacco Processing Machinery	85	118	94	106	81
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	1,532	1,505	1,742	2,056	1,674
Textile and Sewing Machinery	228	292	403	543	408
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	359	478	557	813	624
Pulp, Paper, Printing and Packaging Machinery	382	328	348	472	448
Measuring, Testing and Control Instruments	570	674	818	764	783
Materials Handling Equipment	597	587	524	650	459
Photo and Service Industry Machinery	872	923	988	1,307	1,123
Agricultural Machinery and Equipment	512	550	494	438	401
Computers	583	617	648	619	469
Computer Peripherals, Accessories and Parts	4,114	5,768	7,050	7,929	8,108
Semiconductors	1,438	1,965	3,278	3,876	3,299
Telecommunications Equipment	3,350	3,647	3,851	4,984	4,083
Other Office and Business Machines	2,385	2,446	2,511	2,539	2,368
Scientific, Hospital and Medical Equipment	818	867	984	1,163	1,446

(continued)

Table 50: U.S. Imports from Japan by End-Use Category, 1986-1990 (continued)

(in millions of dollars, Customs value)

	1986	1987	1988	1989	1990
Transportation Equipment	$369	$519	$557	$778	$741
Parts for Civilian Aircraft	189	255	322	387	471
Engines for Civilian Aircraft	53	35	58	97	84
Railroad Equipment	63	134	89	72	46
Marine Engines and Parts	53	55	63	182	140
Automotive Vehicles, Parts and Engines	32,620	33,690	32,789	33,685	32,120
Cars	20,950	21,273	19,873	20,140	19,522
Trucks, Buses and Special Vehicles	5,462	4,726	3,477	2,855	1,964
Bodies and Chassis for Trucks and Buses	188	226	263	86	93
Automotive Engines and Engine Parts	1,014	1,405	2,011	3,087	2,429
Automotive Tires and Tubes	478	498	641	818	752
Other Automotive Parts and Accessories	4,528	5,562	6,525	6,700	7,360
Consumer Goods	15,794	13,940	14,252	12,954	12,919
Manufactured Consumer Nondurables	1,419	1,400	1,450	1,514	1,371
Cotton Apparel and Household Goods	227	182	112	71	53
Other Textile Apparel and Household Goods	219	174	163	123	77
Nontextile Apparel and Household Goods	47	47	43	84	96
Pharmaceutical Preparations	271	336	344	360	341
Printed Material	188	194	218	191	186
Manufactured Consumer Durables	14,195	12,400	12,642	11,370	11,459
Glassware and Chinaware	396	375	333	275	262
Cookware, Cutlery, House and Garden Wares and Tools	249	209	209	192	168
Household and Kitchen Appliances	901	737	625	418	645
Motorcycles and Parts	856	556	629	586	403
Pleasure Boats and Motors	248	322	447	213	162
Toys and Sporting Goods (incl. bicycles)	729	931	1,633	2,108	2,632
Photographic and Optical Equipment	1,021	1,079	952	772	695
Musical Instruments and Other Recreational Equipment	392	544	549	393	350
Television Sets and Other Video Equipment	5,581	3,608	2,810	3,230	3,005
Radios, Stereo Equipment and Other Audio Equipment	2,513	2,754	3,223	2,212	1,945
Jewelry and Watches	467	526	556	356	521
Artworks and Antiques	86	63	43	101	123
Unmanufactured Consumer Goods	179	139	161	70	90
Other Imports	809	814	985	1,061	1,355

Source: Department of Commerce

Table 51: U.S. Direct Investment Position Abroad, Yearend 1986-1990

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
Developed Countries	$194,280	$237,508	$252,649	$274,564	$312,186
Canada	50,629	57,783	62,656	65,548	68,431
United Kingdom	35,389	44,512	49,459	59,827	64,983
West Germany	20,932	24,388	21,832	24,550	27,715
Switzerland	16,441	19,665	18,734	19,209	23,733
Netherlands	11,643	14,842	16,145	18,133	22,778
Japan	11,472	15,684	18,009	18,488	20,994
France	8,952	11,868	13,041	14,069	17,134
Australia	9,340	11,363	12,823	13,331	14,529
Italy	7,426	9,264	9,496	10,294	12,971
Belgium	5,006	7,267	7,501	7,941	9,462
Spain	2,707	4,076	4,966	6,096	7,480
Ireland	4,308	5,425	5,886	5,522	6,776
Norway	3,216	3,843	4,371	3,547	3,633
New Zealand	598	743	833	1,140	3,139
Developing Countries	61,072	73,017	80,060	92,098	105,721
Bermuda	15,373	19,215	19,022	17,717	18,972
Brazil	9,268	10,951	12,609	14,522	15,416
Mexico	4,623	4,913	5,712	7,280	9,360
Panama	5,525	6,622	6,874	7,889	8,521
Hong Kong	3,912	4,3[illegible]9	5,240	5,946	6,537
Bahamas	2,991	3,814	4,112	4,257	4,301
Singapore	2,256	2,384	2,311	2,318	3,971
Indonesia	3,217	3,070	2,921	3,770	3,827
Netherlands Antilles	-16,969	-14,235	-9,983	-5,956	-1,401
International	4,448	3,782	3,184	3,430	3,586
Total	259,800	314,307	335,893	370,091	421,494
of which:					
Petroleum	58,497	59,774	57,807	54,049	59,736
Manufacturing	105,101	131,645	138,725	149,237	168,220
Wholesale Trade	26,214	31,847	34,054	37,230	41,411
Banking	14,5[illegible]	18,027	19,109	20,397	21,397
Finance, Insurance and Real Estate	36,414	53,046	63,386	84,323	98,889
Services	5,128	6,706	7,869	8,716	10,639
Other	13,935	13,262	14,942	16,140	21,001

Source: Department of Commerce

Table 52: U.S. Direct Investment Position in Japan, Yearend 1986-1990

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
Total	$11,472	$15,684	$18,009	$18,488	$20,994
Petroleum	2,712	2,642	3,443	3,284	3,419
Manufacturing	5,439	8,107	8,929	9,721	10,623
Food Products	157	371	334	310	388
Chemicals	1,591	2,159	2,423	2,405	2,509
Metals	130	175	187	161	225
Electric Machinery	475	744	1,070	1,180	1,224
Nonelectric Machinery	1,809	*	2,775	2,585	2,891
Transport Equipment	699	1,231	1,286	2,215	2,464
Other	579	*	854	863	921
Wholesale Trade	2,173	2,933	3,485	3,338	3,820
Banking	204	333	263	150	200
Finance, Insurance and Real Estate	686	1,231	1,298	1,492	2,240
Services	109	157	224	243	288
Other	149	281	366	261	406

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Table 53: Foreign Direct Investment Position in the United States, Yearend 1986-1990

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
United Kingdom	$55,935	$75,519	$95,698	$105,511	$108,055
Japan	26,824	34,421	51,126	67,319	83,498
Netherlands	40,717	46,636	48,128	56,316	64,333
West Germany	17,250	21,905	25,250	29,015	27,770
Canada	20,318	24,684	26,566	28,686	27,733
France	7,709	10,137	13,233	16,822	19,550
Switzerland	12,058	13,772	14,372	18,772	17,512
Netherlands Antilles	9,685	8,062	8,935	9,265	11,150
Australia	5,466	5,369	7,171	7,224	8,394
Sweden	3,963	4,910	4,713	5,303	5,450
Belgium	2,487	3,371	3,471	3,972	4,230
Panama	2,202	2,627	2,878	3,039	3,256
Kuwait	3,771	3,898	3,954	4,113	1,580
OPEC Countries	4,787	4,658	6,487	7,228	5,897
Total	220,414	263,394	314,754	373,763	403,735
of which:					
Petroleum	29,094	37,815	36,006	37,201	38,004
Manufacturing	71,963	93,865	122,582	151,820	159,998
Wholesale Trade	33,997	37,427	43,725	46,297	52,646
Retail Trade	8,923	7,972	9,865	9,013	9,350
Banking	12,394	14,354	16,906	18,638	19,089
Finance	7,239	7,389	8,113	16,837	13,075
Insurance	15,345	17,712	18,991	22,740	26,273
Real Estate	22,512	22,025	25,867	30,060	34,626
Other	18,948	24,837	32,699	41,155	50,675

Source: Department of Commerce

Table 54: Japan's Foreign Direct Investment Position in the United States, Yearend 1986-1990

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
Total	$26,824	$34,421	$51,126	$67,319	$83,498
Petroleum	34	-56	-64	-35	-38
Manufacturing	3,578	4,970	11,065	13,978	15,169
Food Products	158	281	393	641	662
Chemicals	279	932	1,677	2,272	3,918
Metals	471	602	1,293	2,248	2,090
Machinery	1,052	1,686	2,930	4,150	4,210
Other	1,618	1,469	4,772	4,667	4,289
Wholesale Trade	13,687	15,927	18,462	21,972	27,645
Retail Trade	290	373	411	511	627
Banking	2,704	3,655	4,367	4,959	6,025
Finance	2,087	2,994	5,666	9,407	10,402
Insurance	*	188	266	355	477
Real Estate	2,941	4,386	8,190	11,370	15,860
Other	1,306	1,984	2,763	4,802	7,331

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

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REPORT

A Two-Part Report: A and B

NO. 34B
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Battle Brewing Over FY 1992 Budget

The process of compiling the FY 1992 general account budget promises to be more heated than usual as Tokyo tries to juggle conflicting policy goals. In line with guidelines adopted in July by the cabinet of Prime Minister Toshiki Kaifu, total discretionary spending requests are up 5.2 percent, the largest increase since FY 1982 (see JEI Report No. 26B, July 12, 1991). According to some observers, this increase signals the de facto end of the Ministry of Finance's austere fiscal policy. MOF officials counter this interpretation; they say the ministry will slash certain categories to cut total spending and tinker with some politically sensitive budget mechanisms out of concern for the government's steadily growing debt-service costs.

Following the August 31 deadline for FY 1992 budget requests, MOF reported that initial general account requests totaled Y76.2 trillion ($564.3 billion at Y135=$1.00), an 8.3 percent gain over FY 1991's initial total (see Table 1). This figure is composed of requests for Y39 trillion ($288.6 billion) in discretionary spending, Y1.3 trillion ($9.6 billion) for public works funded by the sale of government-held shares of Nippon Telegraph and Telephone Corp., and Y35.9 trillion ($266.2 billion) in nondiscretionary spending.

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Table 1: Summary of FY 1992 General Account Budget Requests

(in billions of yen and percent change*)

	Request	Change
Discretionary Spending	Y38,956.0	5.2%
Industrial Investment Special Account	1,300.0	0.0
Nondiscretionary Spending	35,922.0	12.2
Debt Service	17,546.3	9.4
Transfers to Local Governments	18,375.7	15.0
Total	76,178.0	8.3

*Change from initial FY 1991 budget.

Source: Ministry of Finance

A breakdown of discretionary spending requests by government organization shows that almost every agency expects to win solid budget increases for the year beginning April 1, 1992 (see Table 2). The Japan Defense Agency request for just a 5.4 percent increase to Y4.6 trillion ($34.2 billion) reflects the perception of a lower regional security threat now that the Soviet Union is in a state of internal flux. JDA plans to cut hardware purchases by 4.8 percent to just over Y1 trillion ($7.5 billion) while boosting money for personnel and related costs 11.7 percent to nearly Y1.8 trillion ($13 billion). Foreign aid spending could rise as much as 9.8 percent as Tokyo tries to fulfill a pledge to disburse $50 billion in official development assistance between 1988 and 1992; the rapidly changing situation in the Soviet Union could lead to an even further gain in the ODA budget. Requests for environmental programs rose 5.3 percent to Y506.4 billion ($3.8 billion), an indication of Tokyo's efforts to play a larger role in handling global environmental issues.

The pending FY 1992 general account budget underscores the government's commitment to improve the quality of life. In addition to a Y1.3 trillion ($9.6 billion) transfer to the Industrial Investment Special Account from NTT stock sales, a line item since FY 1988, and a special Y200 billion ($1.5 billion) allocation for infrastructure improvements first authorized in the current fiscal year's budget, MOF plans another Y200 billion ($1.5 billion) special account for public works. The Finance Ministry also has penciled in a 14 percent hike for the Fiscal Investment and Loan Program, a capital budget funded by nontax revenues. Proposed FILP outlays of nearly Y33.2 trillion ($245.7 billion) not only will support housing and road construction but also major foreign aid programs through such agencies as the Export-Import Bank of Japan.

The proposed additions are somewhat misleading. Since total requests by all government agencies were nearly double the Y200 billion ($1.5 billion) per account limit penned by MOF, tough interministerial negotiations lie ahead. The Y1.3 trillion ($9.6 billion) transfer to the Industrial Investment Special Account also is interesting because it is funded by the sale of government-held shares of NTT stock. MOF has announced that it hopes to auction another 500,000 NTT shares before the end of this year, but poor stock market conditions have

Table 2: FY 1992 General Account Budget Requests by Agency

(in billions of yen and percent change*)

Agency	Request	Change
Imperial Household	Y7.6	27.7%
Diet	102.9	5.4
Judiciary	273.4	2.2
Board of Audit	13.8	8.7
Cabinet	14.1	2.1
Prime Minister's Office	8,376.2	3.4
of which: Defense Agency	4,622.0	5.4
Ministry of Justice	502.4	4.5
Ministry of Foreign Affairs	630.7	9.4
Ministry of Finance	1,542.0	9.6
Ministry of Education	5,296.7	4.8
Ministry of Health and Welfare	12,882.2	5.7
Ministry of Agriculture, Forestry and Fisheries	2,668.7	1.4
Ministry of International Trade and Industry	857.2	9.0
Ministry of Transportation	844.4	2.0
Ministry of Posts and Telecommunications	31.0	6.0
Ministry of Labor	488.1	0.2
Ministry of Construction	4,109.6	2.6
Ministry of Home Affairs	115.0	70.3
Infrastructure Investment	200.0	0.0
Total Discretionary Spending	38,956.0	5.2

*Change from initial FY 1991 budget.

Source: Ministry of Finance

clouded the auction's outlook. Although the last such sale was held in 1988, the government has spent only Y5.2 trillion ($38.5 billion) of the approximately Y10 trillion ($74.1 billion) netted from three previous stock sales. Even if the sale is put off again this year, MOF can continue doling out earlier proceeds in increments of Y1.3 trillion ($9.6 billion) for several more years.

MOF will stick with its hard-line position against big discretionary spending increases in the coming fiscal year for two reasons. First, the total amount of outstanding public bonds will continue to grow, surpassing an estimated Y168 trillion ($1.2 trillion) in FY 1992 or over one-third of nominal gross national product. The cost of servicing this debt will outpace again overall budget growth; debt service will eat up 23 percent of FY 1992's projected general account outlays. Last year's growth was almost 11 percent. This inexorable expansion will continue to lead MOF to try to hold the line on discretionary spending in a bid to limit overall spending.

Second, MOF projects that tax revenues will grow only modestly in FY 1992. The revenue situation for the current fiscal year already is throttling spending. The initial forecast for FY 1991 projected tax and stamp revenues of Y63 trillion ($466.7 billion), but the adopted budget shows revenues of only Y61.8 trillion ($457.8 billion). MOF budget planners expect a similar drop-off in FY 1992 as the economy slows. If recent stock and banking scandals (see JEI Report No. 33B, August 30, 1991) cast a larger-than-expected shadow over the economy, MOF may face even tougher spending constraints.

The revenue squeeze has prompted the Finance Ministry to raise a politically explosive idea: adjusting the formula for sharing certain central government tax revenues with local governments. Under the current formula prefectural and municipal administrations receive 32 percent of personal and corporate income taxes, 32 percent of liquor taxes, 24 percent of consumption tax revenues and 25 percent of tobacco taxes. MOF has suggested that local government revenues now are so healthy that the central government's revenue-sharing burden should be reduced. Jockeying over this proposal will add a completely new dimension to the FY 1992 budget process, perhaps impeding its progress.

The budget process still is in the early stages, however. From now until December MOF will hammer out detailed budgets in individual talks with each agency, leaving plenty of time for adjustments and changes.

Jon Choy

BOJ Watchers Anticipate Monetary Policy Shift

As attention in Tokyo turns to what the Bank of Japan might do about a perceived slowdown in the Japanese economy, at least one activity -- BOJ-watching -- has remained a growth industry. The overriding question is: what will Japan's central bank do about the faltering economy and when will it do it? The official answer -- that it will do nothing because nothing needs fixing -- resonates neatly with findings announced in late August by the Economic Planning Agency. EPA officially noted then that Japan's economy had tied the postwar record of 57 months of uninterrupted expansion. The official answer, however, has failed to quiet those who see in government data signs of a slowdown.

Some of the gloomy data comes from the Bank of Japan itself. The September 6 release of BOJ's diffusion index in its quarterly tankan (short-term survey of firms) showed a drop of 9 points from May to register 27 -- the lowest value since February 1988 -- on a scale that ranges from +100 to -100. (The diffusion index is calculated by subtracting negative responses from positive ones.) The tankan still contained some positive information for those hoping for a continuation of Japan's economic expansion. Large firms told BOJ that they plan to increase plant and equipment spending 7.9 percent in the fiscal year that began April 1, while small- and medium-sized companies reported plans to spend 0.4 percent less over the same period than they had in FY 1990. Both results represented upward revisions from the May survey. If these projections pan out, plant and equipment spending, which represented 22 percent of Japanese gross national product in the October 1990-March 1991 period, could provide strong support for an ongoing expansion.

Of course, companies responding to the BOJ survey base their forecasts in part on assumptions concerning central bank policies. One such assumption

Control Law. Under this law Japanese firms intending to export various dual-use items to certain countries must obtain an export license from the Ministry of International Trade and Industry. JAE's alleged involvement in the export of parts for use in missiles without such a license led Japanese police to arrest four JAE managers August 28. The police also reportedly plan to submit to prosecuters an investigative report on four other company officials believed to have had a part in the alleged weapons exports. The accusations leveled in the JAE case are the first against a major Japanese manufacturer under Japan's export control regulations since they were strengthened in the wake of disclosures that a Toshiba Corp. subsidiary illegally had sold sophisticated milling machines to the Soviet Union in the early 1980s. Steps were taken in 1987 both to bolster the legal framework and to strengthen enforcement. The JAE incident has served as a test case for the government's implementation of the revised regulations, Ministry of Foreign Affairs sources note.

The accusations against JAE come at an awkward time for the Japanese government. Prime Minister Toshiki Kaifu recently has indicated that Japan is prepared to take on a larger global political role by advancing arms control. Observers in both Tokyo and Washington are likely to be watching closely to see how the cases against JAE and Aero Systems unfold.

Margo Grimm

U.S. Builders Lobbying For Continued Machine Tool Quotas

The restraints put in place at the start of 1987 on U.S.-bound exports of Japanese-made machining centers, numerically controlled lathes, NC punching and shearing machines and three lower technology product lines are not scheduled to be lifted until the end of this year, but the campaign for extension of the limits has been in high gear for months. Legislators influential on trade and defense industrial base issues and the congressional delegations of major machine tool producing states have joined the domestic industry's trade association in lobbying the Bush administration to extend the voluntary restraint agreement with Japan as well as a similar VRA with Taiwan beyond December 31. Although the wording differs, Capitol Hill and NMTBA - The Association for Manufacturing Technology are delivering the same message to the White House. American machine tool builders have used the restraint period to improve their competitiveness but still are struggling to adjust to a shrunken customer base and aggressive foreign rivals. Without continued help on the trade front, VRA extension proponents add, the domestic industry will not be positioned to meet U.S. defense requirements.

Tokyo worked out an arrangement with Washington in November 1986 to limit exports of six types of machine tools to the United States for five years. It went that route rather than risk a threatened formal finding under Section 232 of the 1962 Trade Expansion Act that imports of machine tools from Japan undermined the viability of an industry essential to this country's national security and an accompanying presidential decision to roll back shipments by bigger margins than the negotiated cutbacks. Under the pact the government agreed to restrict exports of machining centers, NC lathes and NC punching and shearing machines to the U.S. market share levels Japanese suppliers controlled in 1981 -- the last big profit year for the boom-and-bust domestic machine tool industry (see Table 1). That meant a 21-percentage-point reduction in Japan's

Table 1: Estimated U.S. Machine Tool Orders, Shipments and Backlog, 1970-91

(in millions of dollars)

Year	Net New Orders	Shipments	Yearend Backlog
1970	$912	$1,443	$706
1971	861	998	569
1972	1,412	1,019	963
1973	2,613	1,501	2,074
1974	2,583	2,031	2,625
1975	1,277	2,452	1,450
1976	2,203	2,060	1,594
1977	2,995	2,281	2,308
1978	4,349	3,013	3,643
1979	5,621	3,877	5,388
1980	4,754	4,692	5,451
1981	2,945	5,096	3,300
1982	1,498	3,604	1,194
1983	1,696	1,845	1,045
1984	2,916	2,286	1,675
1985	2,528	2,545	1,658
1986	2,125	2,579	1,204
1987	2,119	2,324	1,000
1988	3,591	2,399	2,191
1989	2,808	3,196	1,804
1990	2,965	3,300	1,468
Seven Months 1990	1,657	1,898	1,563
Seven Months 1991	1,358	1,527	1,300

Source: NMTBA - The Association for Manufacturing Technology, Industry Estimate of Machine Tool New Orders, Cancellations, Shipments and Backlog.

1985 market share to 52 percent for machining centers, a rollback from 66 percent to 57 percent for NC lathes and a 24-point cut to 19 percent in the 1985 Japanese market share figure for NC punching and shearing machines. Tokyo also said it would use administrative guidance to make sure Japanese exporters did not exceed their 1985 U.S. market shares in milling machines (3 percent), manual lathes (5 percent) and manual punching and shearing machines (9 percent).

Mainly because of the difficulty of accurately forecasting demand over the short run in the cyclical machine tool business, the quotas on machining centers, NC lathes and NC punching and shearing machines generally have not sliced the U.S. market shares of Japanese exporters to the levels anticipated in the VRA (see Table 2). At a minimum, the agreement has prevented Japan-based suppliers from making additional inroads in the American market for these high technology products. In fact, the restraints have enabled U.S.-owned machine tool builders to regain some of the business lost to their Japanese counterparts in the late 1970s and the first half of the 1980s. Equally important, the industry's trade association says, companies making products covered by the VRA have used the breathing room created by the restraint arrangement to strengthen their product and process competitiveness.

Table 2: Japan's Exports of VRA-Covered Machine Tools to the United States, 1981-90

(in units)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Machining Centers	2,180	1,728	1,957	2,858	3,602	3,435	2,064	1,523	2,350	1,780
Numerically Controlled Lathes	3,878	2,350	1,781	3,201	3,834	4,456	3,177	3,590	3,745	2,315
Other Lathes	642	449	200	254	331	123	111	118	270	135
Numerically Controlled Milling Machines	364	184	180	240	254	106	108	65	62	45
Other Milling Machines	495	1,693	1,570	2,416	2,168	2,317	1,584	1,110	413	122
Shearing and Punching Machines	1,462	1,040	2,369	2,855	2,559	4,824	5,535	3,730	4,076	5,499
of which: Numerically Controlled							n.a.	164	145	137

Note: In 1988 Japan switched its trade classification system. Therefore, the product categories for the 1988-90 period do not always match exactly those for earlier years.

Source: Japan Tariff Association, Japan's Exports & Imports.

In a position paper circulated at both ends of Pennsylvania Avenue in early July NMTBA pointed to the high productivity gains scored by the U.S. machine tool industry between 1987 and 1989 as proof that domestic manufacturers have made effective use of the restraint arrangements with Japan and Taiwan. The trade group also detailed how VRA-affected builders had increased spending for new equipment and research and engineering both absolutely and in relation to sales over the 1986-90 period. It warned, however, that these companies will not be able to reap the benefits of their investments or continue to spend larger amounts for equipment and research -- the keys to a stronger U.S. industry -- if the VRAs are allowed to lapse. Pretax profit margins, NMTBA noted, remain razor-thin despite the limits on Japanese and Taiwanese competition.

The American machine tool industry trade group has had little trouble mobilizing significant congressional support for an extended restraint program, which NMTBA has suggested should run for another three years with an option to renew for two more years. Pressure from Capitol Hill was decisive in getting the White House to respond in 1986 to NMTBA's long-running campaign for import relief. The trade association hopes the same strategy will work a second time. So far, however, the Bush administration officials who will decide whether or not Washington should seek new VRAs with Tokyo and Taipei have not indicated which way they might be leaning. They also have given few hints on whether the extension request will be treated as a national security issue or as strictly a trade matter. Some Washington observers have argued that the machine tool industry might stand a better chance of winning White House support for continued restraints if it can persuade economic policymakers to consider the request for extended VRAs within the national security framework. To date only Department of Commerce officials have backed this approach.

Although Taiwanese officials already are lobbying the White House to let the restraint program expire, the Japanese government has taken no position on the renewal question. Second-guessing some of the concerns in Tokyo is not hard, though. Officials in the Ministries of Foreign Affairs and International Trade and Industry no doubt worry that a VRA extension, no matter what its length, could institutionalize limits on U.S.-bound exports of major machine tool products; all they have to do is look at what has happened under similar circumstances with Japanese shipments of cars and steel to this country. At the same time Japanese policymakers probably worry that shipments might surge if the restraints are ended; that outcome could add pressure to the tense U.S.-Japan trade relationship.

Government officials have received little public guidance from Japan's machine tool industry. Builders that have invested substantial amounts of money in U.S. production facilities -- like Yamazaki Mazak Corp., Hitachi Seiki Co., Ltd., Makino Milling Machine Co., Ltd., Okuma Machinery Works, Ltd. and Toyoda Machine Works, Ltd. -- are said to support an extended VRA, although there is some concern that machine tool exporters in other countries will continue to capitalize on the limits on made-in-Japan shipments. Japanese suppliers that have no onshore production base or that do only some assembly here show some signs of ambivalence but probably would be happy if the export ceilings were lifted.

Susan MacKnight

Notes

Baltic States - The Japanese government September 6 granted formal recognition to the Republics of Estonia, Latvia and Lithuania. Tokyo's decision to extend diplomatic recognition to the Baltic states was made in an evening cabinet meeting and announced soon after the Japanese government received official confirmation that Moscow had recognized the independence of the three republics. Foreign Minister Taro Nakayama said Tokyo would initiate discussions to establish actual diplomatic relations with the Baltics as soon as possible. He added that economic assistance for the republics would be considered after a government mission sent to the region September 1-10 returned to Tokyo. Although some Japanese press reports indicated that Tokyo would join other industrialized nations in extending some type of emergency aid to the Baltic states, foreign aid remains a big question, according to some Ministry of Foreign Affairs representatives.

Following the aborted coup attempt in the Soviet Union and declarations of independence by the three Baltic states, the Japanese government expressed in late August "support for the peaceful realization of independence by these

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REPORT

A Two-Part Report: A and B

NO. 35A

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FOREIGN DIRECT INVESTMENT IN JAPAN

Summary

In recent years more and more foreign companies have expressed an interest in inaugurating or expanding investment activities in Japan, the world's second-largest market and one with comparatively steady growth in domestic demand. Yet despite this interest and the Japanese government's initiatives to improve the investment climate, foreign direct investment in Japan remains relatively invisible when compared to investment opportunities in other industrialized nations.

Among the steps either implemented or under consideration by Tokyo in response to foreign investors' requests as well as Washington's strong suggestions during last year's Structural Impediments Initiative talks are the relaxation of investment regulations and the expansion of loan offerings and tax exemptions. Some concessionary loan rates and information services have been available for several years. Plus, liberalization measures instituted in the 1970s and in 1980 as well as this year have lowered the institutional barriers to foreign direct investment in Japan.

With changes in investment laws and regulations American investors, and, in turn, Washington trade negotiators, have begun to pay more attention to indirect factors, such as the high cost of land, labor shortages, the distribution system and business practices or other social and cultural behaviors that influence the investment climate. Critics say, for example, that Japanese corporate cross-shareholding practices stifle merger and acquisition transactions, especially by foreign investors.

Increasingly, American corporate executives interested in investing in Japan are making more of an effort to meet the

demands of the Japanese marketplace, such as high quality, prompt delivery, after-sales service and long-term business relations. In addition to establishing a branch office or a joint venture firm in Japan, many successful foreign investors there also have incorporated certain Japanese business practices. Some also have located research and development facilities there to deal with specific market requirements. These efforts by investors combined with Tokyo's promotion campaign may begin to contribute to increased investment inflows.

Trend of Foreign Investment in Japan

Determining the extent of foreign direct investment in Japan from official sources is difficult because one of the two principal sources does not trace withdrawals by foreign investors and the other does not reflect domestic investment by the Japanese subsidiaries of foreign companies. Ministry of Finance statistics (one of the two main sources) deal only with new investment transactions, including the expansion of existing ventures; these data, however, do not record withdrawals by foreign investors. Foreign investors that take 10 percent or more of a position in a Japanese company are required by the Foreign Exchange and Foreign Trade Control Law to report such transactions to the Finance Ministry; the regulation applies to firms capitalized at or above a specified level, but, since almost all foreign direct investments are in firms that meet the criteria, coverage is fairly complete. Every six months the Finance Ministry lists the number of cases and the value of equity held according to investor nationality and by industrial sectors.

The other source of foreign investment data is found in the balance-of-payments sheet published monthly by the Bank of Japan and based on International Monetary Fund guidelines. BOP information includes cross-border capital flows both inward and outward for direct as well as portfolio investment. (The latter covers equity and other transactions where effective ownership is not a dimension of the relationship.) In terms of foreign direct investment in Japan, transactions that count as inward, or positive flows, include equity shareholding by foreign investors as well as long-term lending to foreign subsidiaries or branch offices from overseas creditors. Outward flows, conveyed by negative signs, include the full or partial sales of foreign investors' holdings in their Japan-based subsidiary to either Japanese companies or other foreign subsidiaries in Japan. Payment of long-term loans to overseas creditors also is regarded as an outward, or negative, flow.

While MOF's investment figures are compiled at the time that firms notify the ministry of their intention to buy or obtain a loan or bonds, the balance-of-payments data are collected at the time of a transaction. Moreover, investment by Japan-based foreign subsidiaries shows up in MOF's data, but the balance of payments does not include such transactions since they are not accompanied by a cross-border transaction. However, MOF's data do not include long-term loan repayments to overseas creditors, which is reflected in the

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balance of payments. These differences explain why each source is important to consider and why neither is sufficient alone.

Table 1 shows both reported investments and net transactions from data compiled by the Ministry of Finance and the Bank of Japan. During the last decade new investment expanded almost sixfold in both number of cases and total value of equity investment. While the total number of cases consistently increased during the last decade with the exception of 1985 and 1986, total annual values have followed a less predictable path, especially since 1986. For example, the average equity value acquired in 1988 was $608,000, which was almost double 1989's average of $344,000. The fluctuations are explained, in part, by the sensitivity to outliers in investment values; one single large-scale transaction can have a big impact on the total value of annual transactions.

Table 1: Trends in Foreign Direct Investment in Japan, FY 1951-FY 1990

(number of cases and millions of dollars)

Fiscal Year	Equity Capital		Loans and Bonds		Total		Net Transaction Amount
	Cases	Amount	Cases	Amount	Cases	Amount	
1951-80	8,826	$2,979	n.a.	n.a.	8,826	$2,979	n.a.
1981	919	432	n.a.	n.a.	919	432	$151
1982	1,052	749	n.a.	n.a.	1,052	749	492
1983	2,363	813	n.a.	n.a.	2,363	813	403
1984	3,685	493	n.a.	n.a.	3,685	493	14
1985	3,322	780	48	$150	3,370	930	705
1986	3,045	760	34	180	3,079	940	443
1987	3,912	1,453	34	761	3,946	2,214	463
1988	4,236	2,576	32	667	4,268	3,243	-287
1989	5,638	1,941	50	919	5,688	2,860	-286
1990	5,902	2,585	37	193	5,939	2,778	1,124
Cumulative Total	42,900	15,561	235	2,871	43,135	18,432	n.a.

Source: Ministry of Finance and Bank of Japan

Although new investment transactions generally have increased, as represented by MOF's statistics, the net inflow shown in the far right column of Table 1 did not always increase. Despite notice having been filed for more than $2 billion worth of new foreign investment, including loans and bonds, each year since 1987, net transactions in 1988 and 1989 reflected an outward, negative, flow. This stemmed in part from large-scale capital withdrawals by General Motors Corp., Chrysler Corp. and Honeywell, Inc. in this period.

U.S. investors represented the largest single group of foreign investors in Japan on a cumulative basis but dropped to second place in last year's annual total when investors from the Netherlands put in more money in more transactions than any other foreign investors (see Table 2). On a cumulative basis U.S. investors hold 46.5 percent of the total book value of reported investment. American investors also lead in the number of cases with 19.3 percent of

Table 2: Foreign Direct Investment in Japan by Country, FY 1989-FY 1990*

(in millions of dollars)

	FY 1989			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United States	727	$1,642	57.4%	672	$664	23.9%	8,353	$8,573	46.5%
Canada	83	35	1.2	53	142	5.1	725	329	1.8
Netherlands	735	248	8.7	729	734	26.4	2,862	1,464	7.9
Switzerland	403	87	3.1	364	142	5.1	2,[illegible]42	1,157	6.3
West Germany	365	144	5.0	345	259	9.3	2,373	950	5.2
United Kingdom	495	81	2.8	507	54	1.9	3,733	652	3.5
France	388	25	0.9	438	74	2.7	2,431	301	1.6
Other Europe	193	40	1.4	206	98	3.5	1,984	475	2.6
Hong Kong	445	63	2.2	384	62	2.2	4,395	515	2.8
Japan**	333	198	6.9	389	231	8.3	3,780	2,082	11.3
Other	1,521	297	10.4	1,852	317	11.4	9,857	1,933	10.5
Total	5,688	2,860	100.0	5,939	2,778	100.0	43,135	18,432	100.0

*Approval basis. Data exclude disinvestments.

**Investments by Japanese firms with significant foreign participation.

Source: Ministry of Finance

the total. Hong Kong investors ranked ahead of individual European countries in cumulative transactions, holding 10.1 percent share of the total number of cases but were far down the list on amounts invested with 2.8 percent of book value. The average American investment exceeded $1 million, almost twice the Netherlands' average of $511,000. Other averages were $438,000 for Switzerland, $400,300 for Germany, $174,700 for Great Britain, $124,000 for France and $117,200 for Hong Kong. Since U.S. investors entered the Japanese market earlier than other investors, the current American investment value generally is considered to be much higher than the cumulative book value shown in Table 2 because of historically rising prices from the time of the original transactions.

A further indication of the long-term involvement in Japan by U.S. firms is the ranking of 30 U.S.-affiliated companies among the top 50 foreign firms when listed by taxable annual income in 1990; Germany holds second place with six firms, followed by Great Britain with five. But the scale of operation remains small when compared with domestic Japanese companies' taxable income; only IBM Japan Ltd. -- in 17th place -- ranked in the top 100 overall.

Machinery and the chemical industries have been the major draw for foreign investors -- the two industries hold 79.3 percent of total cumulative investment in the manufacturing sector (see Table 3). In manufacturing industries foreign direct investment grew more than 50 percent in FY 1990 over the previous year. The slower growth of investment in the nonmanufacturing sector mainly was caused by a slump of investment in the real estate industry; investment in commerce and retail trade grew by 34 percent.

Despite increasing activity by foreign investors in Japan, the total amount of direct investment remains small compared with Japanese companies' overseas investment and other industrialized countries' acceptance of foreign direct investment. According to the Department of Commerce, the United States, in 1990 alone, accepted $64.4 billion worth of foreign direct investment, which included $51.9 billion invested by U.S. subsidiaries of foreign firms. Of the $64.4 billion U.S. total, Japanese investors provided $20.5 billion. MOF's figures on direct investment by Japanese overseas showed a total of $56.9 billion, of which $26.1 billion was directed to the United States. In comparison, total foreign investment in Japan that same year was $2.8 billion, of which $664 million represented American interests, according to MOF. Viewed in another way, two large-scale transactions by Japanese firms each exceeded the total amount of foreign direct investment in Japan for the period in which they took place. Matsushita Electric Industrial Co., Ltd.'s $6 billion-plus acquisition of MCA Inc. in late 1990 was more than twice the foreign direct investment in Japan for FY 1990. In 1989 Sony Corp. paid more than $3.4 billion to buy out Columbia Pictures Entertainment Inc.; foreign direct investment in Japan for FY 1989 was $540 million less.

Country-by-country comparison of outstanding assets is difficult since most industrialized countries disclose the figures on a current-cost basis rather than using cumulative inflow and outflow figures based on historical costs. Moreover, there is no universal standard of adjustment used to calibrate current values of the outstanding assets. Countries differ, for example, in how they calculate their outstanding overseas assets and the foreign assets in their country, their outstanding debt, and how they adjust for exchange rates, stock market share prices and values of tangible and intangible assets. Nevertheless, a rough comparison is possible. According to MOF's outstanding

Table 3: Foreign Direct Investment in Japan by Industry, FY 1988-FY 1990*

(in millions of dollars)

	FY 1989			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Manufacturing	2,066	$1,172	41.0%	2,030	$1,570	56.5%	18,784	$11,771	63.9%
Food	126	17	0.6	74	29	1.0	1,204	312	1.7
Textiles	13	0	0	26	18	0.6	197	69	0.4
Rubber and Leather	34	29	1.0	7	1	0.0	127	77	0.4
Chemicals	194	203	7.1	234	438	15.8	2,451	3,159	17.1
Petroleum	24	8	0.3	59	30	1.1	524	722	3.9
Nonmetallic Mineral Products	8	6	0.2	73	6	0.2	448	148	0.8
Metals	187	40	1.4	125	151	5.4	992	648	3.5
Machinery	1,093	808	28.3	886	806	29.0	10,274	6,176	33.5
Other	387	61	2.1	546	92	3.3	2,567	461	2.5
Nonmanufacturing	3,622	1,688	59.0	3,909	1,208	43.5	24,351	6,661	36.1
Construction	419	9	0.3	366	9	0.3	1,536	90	0.5
Real Estate	121	647	22.6	114	24	0.9	488	818	4.4
Commerce	1,710	544	19.0	2,057	730	26.3	12,878	2,944	16.0
Services	972	138	4.8	1,098	263	9.5	6,619	1,061	5.8
Transportation	149	47	1.7	63	12	0.4	482	139	0.8
Communications	14	23	0.8	13	21	0.8	113	148	0.8
Banking and Insurance	40	180	6.3	64	109	3.9	311	681	3.7
Other	197	100	3.5	134	40	1.4	1,924	780	4.2
Total	5,688	2,860	100.0	5,939	2,778	100.0	43,135	18,432	100.0

*Approval basis. Data exclude disinvestments.

Source: Ministry of Finance

investment figures calculated at the end of each year using a current-cost basis (see Table 4), the gap between Japan's outstanding investment abroad and outstanding foreign investment in Japan has deepened, especially after 1987 when Japanese investors parlayed a stronger yen into more direct investment abroad. While Japanese outstanding investment was just 1.6 times as large as outstanding foreign investment in Japan in 1972, the gap reached 20.5 times as of the end of last year. According to the Department of Commerce, as of the end of 1989 the outstanding U.S. direct investment abroad on a current-cost basis totaled $535.8 billion, or 1.17 times the outstanding foreign investment in this country of $457.6 billion. Similarly, the Bank of England's figure for outstanding overseas investment as of the end of 1989 rang up 1.7 times higher than the outstanding foreign investment in that country. The Bundesbank's statistics for calendar year 1990 showed that Germany's outstanding foreign investment was 2.2 times higher than the outstanding foreign direct investment there. Even taking varying methods of calculation into account, the difference in this international comparison highlights Japan's significant gap between investment assets and debts.

Table 4: Japan's Outstanding Direct Investment Abroad and Outstanding Foreign Direct Investment in Japan, Yearend 1972-90

(in millions of dollars)

Year	Japan's Outstanding Investment Abroad	Outstanding Foreign Investment in Japan	Ratio
1972	$2,574	$1,645	1.6
1975	8,322	2,084	4.0
1980	19,612	3,270	6.0
1985	43,974	4,743	9.3
1986	58,071	6,514	8.9
1987	77,022	9,018	8.5
1988	110,780	10,416	10.6
1989	154,367	9,160	16.9
1990	201,441	9,850	20.5

Source: Ministry of Finance

Some economists reason that the huge gap between Japanese investment overseas and foreign investment in Japan stems from that country's investment-savings imbalance. Japan's domestic savings, especially in the private sector, has exceeded its domestic investment since 1981, allowing the net excess to be invested abroad, although not necessarily in foreign direct investment. If a large proportion of the nation's private foreign asset transactions went into direct investment, there would be a tight link between the investment-savings imbalance and the net flow into foreign direct investment. However, the proportion of the Japanese private sector's foreign direct investment to its total outstanding overseas assets was only 12.1 percent as of the end of 1990. The remainder consisted of loans, bonds and security issues.

In addition to foreign direct investment being only one form of outbound flow, the investment-savings linkages do not explain the gross levels of inbound and outbound investment. The investment-savings imbalance is only one of the factors that contributes to the heavy foreign investment by Japanese firms, the strength of the yen being another. The domestic regulatory framework and international differences in markets have a significant influence on the side of the equation affecting foreign investment in Japan.

Investment Regulation

Japan no longer has any significant regulatory restrictions against foreign investment. Until the early 1970s, though, Tokyo enforced protective regulations on investments out of a concern that domestic industry was weak compared to powerful foreign enterprises. Now, with Japanese industry regarded as one of the strongest in the world, Tokyo has no excuse to maintain restrictive measures on foreign investment. In fact, government ministries have taken steps to open the Japanese market to foreign investors to help pacify overseas criticism and relieve investment frictions that have arisen from the contrast between an overwhelming Japanese presence abroad and a relatively invisible foreign presence in the domestic market.

The original Foreign Investment Law enacted in 1950 aimed to put all kinds of foreign capital flows under the control of the Japanese government. Only a limited amount of foreign direct investment -- that which then was judged as not being in an area in competition with Japanese industry -- was permitted on condition that the foreign affiliates could not send profits to their overseas parent companies. Foreign currency exchange was allowed, as was remittance of profit, starting in 1964. IBM Japan and Coca-Cola Co.'s Japanese subsidiary were established under these early conditions.

As Japan entered the club of industrialized nations, becoming a member of the Organization for Economic Cooperation and Development and the General Agreement on Tariffs and Trade, Tokyo was urged to liberalize its investment regulations in line with international accords. Between 1967 and 1973 Tokyo implemented a package of liberalization reforms; eventually it allowed up to 100 percent foreign ownership in all but 17 industries with prior approval of the government. The Big Three U.S. auto manufacturers, for example, took advantage of the 1971 liberalization measure to gain equity shares in Mitsubishi Motors Corp., Mazda Motor Corp. and Isuzu Motors Ltd.

Further liberalization reforms were enacted in 1980. The Foreign Investment Law was replaced by a Foreign Exchange and Foreign Trade Control Law. Under the new regulation all but four industries -- petroleum, leather, mining and agriculture, forestry and fishery -- were, in principle, open to foreign investors. Even in the four industries where limitations apply, some foreign investment has been allowed, such as in petroleum refining and sales.

Prior notification to the Finance Ministry through the Bank of Japan substituted for the previously required government approval. The government, however, retained the right to object to any foreign investment deemed a possible threat to national security or related interest; that right also could be exercised if a foreign investment was considered able to adversely effect the smooth performance of either the Japanese economy as a whole or an industrial sector related to the projected investment. Tokyo also retained the right to reject investment from the viewpoint of reciprocity. Washington negotiators at the 1990 Structural Impediments Initiative talks and private investors more generally were not fully satisfied by the 1980 amendment of the investment regulations. They contended that the prior notification and review requirement process was too broad as well as too vague and constituted a de facto government approval mechanism. In essence, the regulation was not much different from the previously applied government approval requirement. The prior notification process also typically caused an unnecessary delay in operations, which discouraged foreign investment in general.

Responding to Washington's complaints, Tokyo amended the 1980 Foreign Exchange and Foreign Trade Control Law at the last regular Diet session, which ended in May; the new framework will be enforced as soon as related regulations are prepared. The new approach requires foreign investors to make only ex post facto reports to the government, except in investments involving the currently restricted four industries and those that might imperil national security or the smooth performance of the Japanese economy. For the convenience of foreign investors Tokyo also promised to issue a broad list of industries exempt from prior notification. In judging the influence on national security or smooth economic performance Tokyo promised to keep its interpretation as narrow as possible. For example, the inclusion of related domestic industries, previously mentioned as a measure for judging the effect on economic performance, was deleted. Japan's newly introduced investment regulations are expected to be equivalent to other industrialized nations' criteria. Although investment in some particular industries -- such as broadcasting, telecommunications, air and marine transport and financial services -- remains under licensing requirements or some other form of government control under separate regulations, legal restrictions on foreign investment as a whole were mostly dismantled by this year's amendment.

Japan's Climate for Foreign Investment

Although most investors in Japan appreciate the recent improvements in foreign investment regulations, social factors and a variety of economic forces still present obstacles to inbound foreign direct investment. In a 1991 survey of more than 1,200 American companies in both the United States and Japan by the American Chamber of Commerce in Japan, respondents pointed out several barriers that they have to surmount when they enter the Japanese market or try to increase their business opportunities there.

Most of the issues raised in the survey also were on the agenda of last year's SII talks between Tokyo and Washington. The principal complaints centered on: the high fixed cost of doing business, especially at the initial stage, mainly because of high land prices or office rent; the difficulties in hiring and keeping personnel because of Japan's tight labor market and a seniority-based pay system that can pose problems for people wanting to change jobs; complicated and unique business practices, such as the distribution system; *keiretsu* practices in which corporate groups engage in cross-shareholding among members of the group; and a lack of transparency in ministry guidelines and other regulatory measures. Some ACCJ members also complained that the Japanese government provided relatively few incentives, like tax exemptions and financial support, to facilitate inward investment. Despite these complaints, the survey also found that 63 percent of the 340 respondents expect the climate for trade and investment in Japan will continue to improve over the next five years.

High fixed costs - Japan's population and information centers are grouped in metropolitan areas, primarily in the Tokyo area, contributing to tremendously high real estate prices -- especially office rent in Tokyo. Moreover, land prices, on average, have more than doubled in the last five years, in part because of heavy speculation in land (see JEI Report No. 28A, July 20, 1990). Almost two-thirds of American companies answering the ACCJ survey addressed the difficulty of finding a reasonable price for adequate office space in Tokyo or a factory site in industrial areas. Foreign investors planning operations in Japan usually do not expect to show any net profits in the first three to five years because the purchase of real estate or the establishment of an office is such a high fixed cost at the start of the venture.

In response to Washington's requests at the SII talks government officials introduced a land reform package late last year to reduce, or at least to stabilize, land prices by enacting new taxes on land held for speculative purposes, reviewing land-use policies and restricting both banks' and nonbanks' loans for land purchases (see JEI Reports No. 45B, November 30, 1990, No. 47B, December 14, 1990 and No. 5B February 8, 1991). The Japanese government also is preparing to extend no-interest loans to the semi-public sector to construct office buildings for foreign tenants. Revenue from the sale of government-owned stock in Nippon Telegraph and Telephone Corp. will be used for the program, which also will receive guarantees from the Japan Development Bank. Some American- and European-affiliated firms also have begun coping with space problems by introducing to their work place the greater density of Japanese office layouts in which managers and employees work in the same room.

Although the price of industrial sites is relatively expensive even in the countryside, some local governments have acted out of concern for their economies by actively inviting foreign companies, especially high-tech companies, to establish offices and plants in their localities. Since local governments have very little independence from the central government in Japan, the assistance that central government officials can give local authorities is an important factor in attracting foreign investors. The central government is encouraging local government initiatives by planning to enlarge subsidies related to the invitation to foreign investors.

Financial Incentives - The Ministry of International Trade and Industry is planning to introduce a financial and tax incentives program from FY 1992, which starts next April, in a bid to help foreign investors in Japan. The affiliates of foreign-based companies in Japan currently can access government financial assistance through the Japan Development Bank, meeting the same standards that apply to companies headquartered in Japan. In addition to general loans, two categories of special low-interest loans are available for foreign-affiliated firms. One type is set aside for companies engaged in high-tech industries, such as electronics, fine chemicals, new materials, biotechnology or advanced software development. The other type of loan is aimed at encouraging foreign investment that may contribute to a significant increase in Japan's imports. Such investments as wholesale and retail sales are eligible for the latter category. In FY 1990 the Japan Development Bank issued Y23.2 billion ($171.9 million at Y135=$1.00) of special interest loans as well as Y21.8 billion ($161.5 million) of general loans (see Table 5). To facilitate and expand foreign investors' access to the government loans, MITI asked the Japan Development Bank to abolish the sectoral conditions on special loans; all foreign investors will be able to access concessionary loans from FY 1992 regardless of the sector of investment.

Table 5: Japan Development Bank Loans to Foreign-Affiliated Companies, FY 1987-FY 1990

(in billions of yen)

	FY 1987	FY 1988	FY 1989	FY 1990
By Program				
Facilities for Imported Products	Y4.4	Y8.2	Y9.7	Y13.9
Promotion of Direct Investment in Japan	10.6	6.8	5.3	9.3
Other	14.2	21.3	28.9	21.8
Total	29.2	36.3	43.9	45.0
By Country				
United States	17.0	27.4	22.0	23.3
West Germany	8.3	6.0	8.8	11.1
Others	3.9	2.9	13.1	10.6

Source: Japan Development Bank

In the area of tax incentives Japan's tax code currently allows a tax loss carry-forward for an initial five-year period; this span is considered too short for many foreign investors to recover their initial fixed costs. MITI officials intend to extend the tax-exempt period for initial foreign investment as well as to set up more foreign trade zones, or bond zones, from FY 1992 in line with the ministry's promotion program for inward investment. While Tokyo has established the framework for free enterprise zones, only the Naha Airport area on Okinawa has instituted a tax haven program for offshore investment. The imported materials and goods to be assembled or used there have been exempted from already low Japanese tariffs; foreign firms further have been encouraged to set up there, provided their resulting products are reexported, by being allowed a reduction of some local real estate taxes.

Labor shortage - Japan's currently tight labor market reflects a nearly five-year-long economic boom and a long-term demographic trend that shows a continuous decline in the working-age population. Many foreign investors, thus, have faced difficulties in recruiting qualified employees in Japan, especially at the initial stage of their operation. Worsening the situation has been the traditional Japanese practice that leads to expectations of a career-long position within one company; this cuts the chance that middle-aged managers and engineers would shift to other companies, particularly since the seniority-based pay system complicates matters when someone of middle age shifts to a new firm.

The tight labor market, however, is motivating changes that work to the advantage of foreign investors. As the labor market becomes a seller's market, more workers are considering switching jobs in search of better job conditions. The rapid change of Japan's industrial structure also has accelerated changes in the labor force. The Labor Ministry released in September a survey that indicated in 1990 alone 3.17 million workers changed their jobs. This number exceeded last year's total addition of 2.35 million new employees in the work force. Last year job changes as a ratio of the total employed work force amounted to 5.07 percent. This was up 0.73 percentage point, or 530,000 job-changers, from 1987. Job shifts are found more frequently among younger workers; this suggests that the career-long employment practice, especially the guarantee of a permanent job, is declining as a decisive factor in attracting young workers to a particular firm.

Another factor for changing Japanese workers' attitudes toward jobs is that, as Japanese companies have become globalized, many Japanese workers and their families have experienced living and working abroad where different employment practices take place. In 1990, for example, 57 percent of Japanese companies with 1,000 to 4,999 employees, and 88 percent of those with more than 5,000 workers, posted a number of their employees abroad. Since some of these workers and their families have become accustomed to Western life-styles as well as labor practices, they have fewer difficulties working for a foreign-affiliated company than older, less international, workers might. Moreover, many Japanese workers recently have become more concerned about leisure activities, spending time with their families and even becoming involved in community activities. Some of these employees care more about working conditions, including the length of the workday, than about wages when they judge where they want to work. In this regard foreign-affiliated companies often provide more attractive conditions for their employees. For example, Fuji Xerox Co., Ltd. and IBM Japan have introduced long-term paid leave for their employees engaging in voluntary community activities.

Mergers and Acquisitions - To reduce initial operating costs and lessen the difficulties of recruiting personnel, a corporate merger or the acquisition of an existing firm is considered a suitable way of entering business in many countries. In the United States and Europe, for example, M&A is a tool widely used by foreign investors; of last year's $64.4 billion in foreign direct investment in the United States, $56.8 billion, or 88.1 percent of the total, involved acquisitions with the remainder consisting of green-field investment, according to the Commerce Department. In this country the selling and the buying of corporate ownership are common business practices, facilitated by institutionalized procedures in the security and the banking markets, like takeover bids and leveraged buyouts.

In contrast to the American market, M&A transactions are scarce in Japan. A Japanese security company's 1991 survey indicated that only 311 M&A cases occurred last year in Japan, including Japanese companies' acquisition of Japanese companies as well as foreign firms' acquisition of Japanese companies (see Table 6). In contrast, Japanese firms acquired 440 companies abroad last year. Of the 311 M&A cases in Japan foreign investors were involved in barely 18. Although Japanese overseas M&A activities increased by more than four times between 1985 and 1990, foreign companies' acquisitions of Japanese firms decreased from 26 to 18 during the same period. Since details of the transactions are not fully open to the public, data are not available for the total value of the transactions. Some researchers have estimated from the disclosed transactions that when a Japanese firm acquired a foreign company in 1989 the average value amounted to Y11.2 billion ($83 million). This far exceeded the average value of M&A between Japanese companies, estimated at Y2.2 billion or $16.3 million, as well as foreign firms' acquisition of Japanese companies, put at Y3.6 billion ($26.7 million). It should be stressed that these estimates are rough, since the available samples are too small to analyze or describe the total picture and even a single large-scale transaction can have a great influence on the average value.

Table 6: Number of Mergers and Acquisitions Involving Japanese Firms, 1981-90

Year	Japanese Firms Acquire Japanese Firms	Japanese Firms Acquire Firms Abroad	Foreign Firms Acquire Japanese Firms	Total
1981	122	48	6	176
1985	163	100	26	289
1986	226	204	21	451
1987	219	228	22	469
1988	223	315	17	555
1989	240	405	15	660
1990	293	440	18	751

Source: Yamaichi Securities Co., Ltd.

There are several explanations about why M&A transactions are rare in Japan, especially those that involve foreign investors (see JEI Report 14A, April 6, 1990). Some analysts tie the scarceness to the keiretsu-style practice of Japanese companies engaging in mutual shareholding among members of a corporate grouping. Other analysts focus on not-yet-matured Japanese stock and financial markets where neither M&A techniques nor M&A preventive practices have been developed. Another suggested factor is the general Japanese corporate attitude that tends to regard selling and buying companies as immoral, much like buying or selling a family.

The mutual shareholding practice, in fact, is closely related to a general corporate approach that is hostile to takeovers. When members of a corporate group hold significant amounts of equity in a company, and keep those shares from being traded, outsiders have little opportunity to acquire a majority stake in a firm. Although the average value of a financial keiretsu member held by members of the group adds up to well below 50 percent -- between 12 and 27 percent -- of the total equity (see JEI Report No. 2A, January 12, 1990), it is often large enough to cement ties among member companies. Technically it might be possible for outsiders to buy a majority stake in a certain keiretsu member if sufficiently large takeover partners could unite in a concerted action. In reality, however, any hostile takeover attempt most likely would be blocked by the collective actions of other group members, which would seek to increase their shares to the majority level. Given such circumstances, takeover attempts rarely succeed in Japan without the agreement of existing institutional shareholders. Other analysts also indicate that cross-shareholding functions as a substitute for the defensive measures that work against takeover attempts in other countries, such as stock buy-back plans, the conversion of a public firm into a privately held one, and the issuance of nonvoting stock.

Although the number of M&A transactions remains small in Japan, acceptance of the transaction gradually is growing there. As Japanese corporations become more actively involved in M&A activities abroad, such transactions are losing their immoral taint at home, at least in corporate eyes. For example, Mitsui Bank Ltd.'s 1990 merger with Taiyo Kobe Bank Ltd. was seen as a way of strengthening their collective competitiveness in the face of coming fundamental liberalization of Japan's financial services. Moreover, the Japanese government has supported the acquisition by larger companies of almost bankrupt firms as a rescue measure. Further evidence of a changing outlook is that more and more brokerages anxious to be more active in mediating transfers of corporate ownership have established M&A divisions. Even family-owned small- and medium-sized firms sometimes use the mediation services of these security companies if the present owners cannot find by themselves an appropriate successor within their family or among acquaintances.

The Japanese government also has begun to improve legal and institutional aspects regarding M&A activities. The first step was made with the December 1990 introduction of a requirement that shareholders with over 5 percent of the total equity of a firm disclose details of the acquisition to authorities (see JEI Report No. 3A, January 25, 1991). Tokyo also has improved measures related to takeover bids since then. Barely three takeover bids occurred prior to the change; three cases have developed in the first half of this year alone.

The Ministries of Finance and of International Trade and Industry are studying further liberalization of the securities markets with the purpose of harmonizing relations with other industrialized economies, including improved transparency as well as protection of investors. Reviews of the Security Exchange Law, the Corporate Law, the Foreign Exchange and Foreign Trade Control Law, the Antimonopoly Law and other related regulations are proceeding in line with the liberalization of the Japanese security market and the promotion of foreign inward investment. Although a quick change in cross-shareholding practices and corporate attitudes hardly is expected in the short-run, legal and institutional improvements in M&A activities may contribute to positive acceptance of M&A transactions by Japanese corporations in the long run. Follow-up talks on the Structural Impediments Initiative also will keep the pressure on Tokyo to follow through on its liberalization and transparency measures. Despite changes in the foreign ownership opportunities in Japan Washington feels more can be done (see JEI Report No. 4B, February 1, 1991).

Japanese Business Practices - For any foreign investor, understanding the business practices in a host country is critical to success. Apart from differences in language and culture many foreign investors have trouble understanding and coping with Japanese business practices. Japanese companies, for example, put a priority on stable and long-term relationships with their business counterparts; this takes time, perseverance and patience for foreign newcomers unfamiliar with the Japanese market. Since severe competition is the rule among enterprises in Japan, customers have very strict expectations. Firms have to be concerned not only about the price of products but about quality, prompt delivery and after-sale services.

Despite the difficulties of understanding and responding to Japanese business practices, some foreign companies have achieved significant success in the Japanese market. Successful companies, in general, accept Japanese business practices as a given factor, rather than as an impediment, and actively adjust themselves to the Japanese ways of business. The 1991 survey by the American Chamber of Commerce in Japan shows that those companies that promote local authority are more successful than those companies with limited autonomy from their overseas parent. Successful companies, the survey indicated, are those that allow their subsidiaries a wider range of decisionmaking powers, including budgeting. They have hired many Japanese executives to manage the company. Some also have established research and development facilities in Japan to develop and design products to meet the specific requirements of Japanese customers. The relatively high standards of Japanese buyers indicate that products made in Japan by foreign-affiliated firms probably could win markets back home and in other countries.

Although the complicated Japanese distribution network has been called a nontrade barrier, some American and European companies have solved the problem by establishing their own sales subsidiaries in Japan and setting up their own distribution market. For example, Bayer AG, which until March 1990 had sold through a Japanese pharmaceutical company's outlets, now has developed its own dealership in Japan. Procter & Gamble Co. contacted several Japanese warehouses to establish its own sales network, independent of traditional Japanese distribution channels. By forging their own distribution linkages, foreign companies can respond more quickly to customers' requests as well as collect more timely market information. Such practices, however, further increase the size of the necessary initial investment and the fixed costs involved in the transaction.

Market information is considered a key to success in the Japanese market. The Japan External Trade Organization provides basic information and advice to foreign investors interested in the Japanese market through its Tokyo headquarters as well as its overseas branch offices. Japanese private business organizations also help foreign investors. For example, Keidanren (the Japan Federation of Economic Organizations) established in 1986 an in-house committee of foreign-affiliated corporations, involving about 50 Japanese subsidiaries of foreign companies. Based on the requests of the Japan-sited foreign affiliates the organization urged the government to improve the import and investment climate in Japan. The committee plans to host a seminar on foreign investment in Tokyo at the end of September inviting over a hundred Japan-based foreign corporate executives and representatives from OECD member countries' embassies. In addition to these official and semi-official moves, a swarm of consulting companies has opened offices in Japan and the United States to advise clients on investing in a gradually opening Japanese economy. It will take some time, though, to observe whether this collection of actions is paying off in greater investment flows.

As Japanese companies have become more deeply involved in overseas operations through trade and investment, they have begun to acknowledge that their relationship with the government and some of their business practices -- which have remained almost unchanged from the days when the Japanese economy was protected closely by the government -- are no longer appropriate for the current economic and political situation. The Japanese business sector can share most of the views raised by Washington at the SII talks on inward investment. The private sector remains concerned that perception of a one-way flow of trade and investment from Japan might cause retaliation against Japanese companies in overseas markets.

Although the current level of investment inflow is low for an economy the size of Japan's, the investment atmosphere is changing. Foreign investors expect improved trade winds as Tokyo continues to dismantle investment controls and expand import and inward investment promotion measures to foreign investors. Whether or not, and to what extent, the amount of inward investment will increase will depend more and more on foreign investors' efforts to cope with Japanese market demands.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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RESEARCH AND DEVELOPMENT IN JAPAN, 1991 UPDATE

Summary

Research and development in Japan continues to be a high, if not major, priority of private and government planners, as shown by the solid growth of aggregate R&D spending. Commercial application of new technology also remains a major goal of both types of planners. Japan's drive to become a net contributor to the global storehouse of scientific resources is gaining momentum, but the consequent shift in R&D spending patterns is lagging. Foreign participation in Japanese research and development is expanding as individual foreign firms take the initiative to engage in programs sponsored by Tokyo as well as private Japanese companies.

Overview

Having rebuilt national research and development capabilities to a par with those of the United States and European countries, Japan's private and government R&D planners have accepted the challenge of making their contribution to global science and technology reflect Japan's economic strength. After decades in which the goal was to catch up technologically with Western industrialized nations, Tokyo has announced that sharing as well as developing technology will be a key part of its new international responsibilities. Accordingly, the government has taken steps to go beyond opening its R&D programs to foreign participation to include input at the planning stage of government projects -- for example, allowing foreign membership on advisory councils. Tokyo also has launched new projects that envision foreign participation as an integral component. If Japan's global R&D contributions are to continue to be expanded, policymakers there will face demands to boost overall spending and to address new priorities and roles.

Aggregate statistics - According to the latest government survey released early this year, total R&D spending in Japan rose 11.2 percent to Y11.8 trillion ($87.5 billion at Y135=$1.00) in the year ending March 31, 1990 (see Table 1a). The FY 1989 figure represents a return to double-digit growth last seen in FY 1985. The sharp drop in the growth rate registered in FY 1986 and its subsequent rebound clearly indicate that Japanese R&D spending is influenced by the pace of overall economic activity.

Data arranged by spending organization shows the corporate sector extending its lead with a 14.1 percent gain to just over Y8.2 trillion ($61 billion). The FY 1989 performances by universities -- up 5.7 percent to just over Y2.1 trillion ($15.8 billion) -- and research institutions, which registered a 4.2 percent increase to more than Y1.4 trillion ($10.8 billion), were significant improvements over the previous year. The pickup in spending by research institutions is particularly striking -- FY 1989's growth rate being six times that recorded in FY 1988. While the government survey does not list a cause for this rebound, one possible explanation is that the impact of economic cycles on spending by research institutions is delayed because their funding is based on multiyear contracts. FY 1988's meager performance may have resulted from the 1985-1986 economic downturn. Another explanation is that outlays by research institutes inherently are volatile since their income depends on the contracts they can attract; with private companies conducting the bulk of their research in-house and government spending subject to political vagaries, funds available to research institutes may vary widely from year to year.

Projections of double-digit profit growth for FY 1989 prompted companies to expand their share of total R&D spending that year to a new record of just under 70 percent. Despite growth rates above the previous year, both universities and research institutions saw their slice of the spending pie shrink in FY 1989. While the share of research institutions has remained within a range of 12 to 14 percent over the past seven years, universities' share has dwindled steadily, falling 5 percentage points between FY 1983 and FY 1989.

The private sector leads the way when the data are presented according to funding source (Table 1b). The business community's 13 percent expansion in FY 1989 confirmed that the negative effects of the 1985-1986 downturn have dissipated entirely. Moreover, the private funding surge reduced the share of the other sources. Public R&D funds grew 4 percent in FY 1989, a sharp improvement over the previous period's tiny 0.3 percent gain. The uptick, however, was only average compared to the past several years. It was not enough to elevate the government's share of total R&D funding back above the long-term 20 percent line held prior to FY 1988; in fact, the 18.6 percent level represents a new low. Previous years have shown that the R&D budget is not safe from the Ministry of Finance's fiscal austerity axe. Whether Tokyo's new commitment to become a global technology source shields government R&D spending against MOF's budget cutters in fiscal year 1992 will be an important indicator of Japan's attitude toward its international role.

For the second year in a row data on Japanese R&D by purpose cast doubt on Japan's willingness to become a source of basic research knowledge. Money

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Table 1: Japan's R&D Expenditures, FY 1983-FY 1989

(in billions of yen and percent)

a. By Spending Organization

Fiscal Year	Companies	Research Institutions	Universities	Total
1983	Y4,560.1	Y971.0	Y1,649.6	Y7,180.8
Change	12.9%	2.3%	7.1%	10.0%
Share	63.5%	13.5%	23.0%	100.0%
1984	5,136.6	1,033.1	1,724.2	7,893.9
Change	12.6%	6.4%	4.5%	9.9%
Share	65.1%	13.1%	21.8%	100.0%
1985	5,939.9	1,160.6	1,789.8	8,890.3
Change	15.6%	12.3%	3.8%	12.6%
Share	66.8%	13.1%	20.1%	100.0%
1986	6,120.2	1,240.2	1,832.6	9,192.9
Change	3.0%	6.9%	2.4%	3.4%
Share	66.6%	13.5%	19.9%	100.0%
1987	6,494.3	1,384.5	1,957.9	9,836.6
Change	6.1%	11.6%	6.8%	7.0%
Share	66.0%	14.1%	19.9%	100.0%
1988	7,219.3	1,394.2	2,014.1	10,627.6
Change	11.2%	0.7%	2.9%	8.0%
Share	67.9%	13.1%	19.0%	100.0%
1989	8,233.8	1,452.3	2,129.4	11,815.5
Change	14.1%	4.2%	5.7%	11.2%
Share	69.7%	12.3%	18.0%	100.0%

b. By Source of Funds

Fiscal Year	Government	Private	Foreign	Total
1983	Y1,721.4	Y5,451.1	Y8.2	Y7,180.8
Change	3.3%	12.3%	17.1%	10.0%
Share	24.0%	75.9%	0.1%	100.0%
1984	1,777.8	6,108.6	7.6	7,893.9
Change	3.3%	12.1%	-7.3%	9.9%
Share	22.5%	77.4%	0.1%	100.0%
1985	1,867.3	7,014.9	8.1	8,890.3
Change	5.0%	14.8%	6.6%	12.6%
Share	21.1%	78.6%	0.1%	100.0%
1986	1,955.3	7,229.7	7.9	9,192.9
Change	4.7%	3.1%	-2.5%	3.4%
Share	21.5%	78.4%	0.1%	100.0%
1987	2,111.8	7,716.6	8.2	9,836.6
Change	8.0%	6.7%	3.8%	7.0%
Share	21.5%	78.4%	0.1%	100.0%
1988	2,117.8	8,501.5	8.3	10,627.6
Change	0.3%	10.2%	1.2%	8.0%
Share	19.9%	80.0%	0.1%	100.0%
1989	2,202.4	9,603.3	9.7	11,815.5
Change	4.0%	13.0%	16.7%	11.2
Share	18.6%	81.3%	0.1%	100.0%

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

for developmental work, which leads directly to commercial products, played a larger role in total R&D budgets in FY 1989, while the proportion allotted to basic research edged back for the second year in a row (see Table 2). If anything, the data indicate that Japan is pulling back from basic research in favor of commercialization. Developmental research won an increased piece of the total spending pie in all but one of the past seven years. The most likely reason behind this trend is the dominant role of private R&D spending in Japan. Despite the fabled long-term outlook and patience of Japanese management, R&D spending, as a whole, still must earn a satisfactory rate of return or make a positive contribution to a company's competitive strength. Private R&D spending naturally tends toward commercial applications, pushing overall spending in the same direction, since the private sector accounts for the majority of Japanese R&D spending and shows the highest growth rate.

Table 2: Japan's Research Expenditures by Purpose, FY 1983-FY 1989

(in billions of yen and percentage share)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1983	Y896.7	Y1,630.1	Y3,882.8
	14.0%	25.4%	60.6%
1984	959.9	1,780.8	4,340.2
	13.6%	25.1%	61.3%
1985	1,030.6	2,001.8	4,985.9
	12.9%	25.0%	62.2%
1986	1,102.8	2,030.8	5,185.0
	13.3%	24.4%	62.3%
1987	1,250.2	2,166.8	5,497.3
	14.0%	24.3%	61.7%
1988	1,288.0	2,346.6	6,041.0
	13.3%	24.3%	62.4%
1989	1,390.9	2,588.4	6,848.0
	12.8%	23.9%	63.2%

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

Data broken down by purpose by spending organization underscore both of the above trends (see Table 3). The breakdown of corporate work among basic, precommercial (applied) and commercial research shows a tiny shift in FY 1989 away from the first two categories in favor of the latter. This shift obscures the fact that since the shares changed very little, the growth of basic research by companies still must be only slightly lower than the growth rate of overall company spending, 14.1 percent. Although basic research outlays by both universities and research institutions declined in FY 1988, they were up as a percentage of total spending in the latest figures. Analysts viewed the modest boost in basic research undertaken by universities as a positive sign (since this category constitutes the bulk of basic research in Japan), yet FY 1989's 53.2 percent mark still is short of levels common between FY 1983 and FY 1987. The gain in basic R&D budgets at research institutions is more positive since

Table 3: Japan's Research Expenditures by Spending Organization by Purpose, FY 1983-FY 1989

(share of each organization's total expenditures in percent)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1983			
Universities	57.4%	35.0%	7.6%
Research Institutions	13.2	33.2	53.6
Companies	5.2	21.8	73.0
1984			
Universities	54.9	36.9	8.3
Research Institutions	12.6	30.9	56.5
Companies	5.7	22.0	72.3
1985			
Universities	54.2	37.4	8.4
Research Institutions	12.3	30.0	57.7
Companies	5.9	21.9	72.1
1986			
Universities	54.2	37.4	8.4
Research Institutions	13.8	27.4	58.8
Companies	6.1	21.6	72.3
1987			
Universities	54.2	37.4	8.4
Research Institutions	15.8	26.0	58.2
Companies	6.6	21.7	71.7
1988			
Universities	52.8	38.5	8.7
Research Institutions	14.9	25.4	59.7
Companies	6.6	21.7	71.7
1989			
Universities	53.2	38.1	8.7
Research Institutions	15.3	25.7	59.0
Companies	6.4	21.5	72.2

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

FY 1989's 15.3 percent share is near the historical high of 15.8 percent reached in FY 1987.

Government Spending - Faced with ballooning interest payments on the national debt, Japanese budget planners have been preoccupied with fiscal austerity since the early 1980s (see JEI Report No. 17A, May 3, 1991). To balance the budget the Ministry of Finance has asked other government agencies to freeze capital expenditures (such as public works and other infrastructure) and reduce current operating outlays (including administrative costs and wages) by 5 percent each year. The government was able to keep a lid on new spending through the mid-1980s, but its grip began to slip at the end of the decade and has become almost loose as Japan strives to meet greater domestic and international expectations. The importance Tokyo attaches to R&D clearly is more than rhetorical but is not unbounded. Table 4 shows that the growth of research outlays

Table 4: Japanese Government Research Expenditures as a Share of the General Account Budget, FY 1982-FY 1991

(revised budgets in billions of yen and percent)

a. As a Share of Total Expenditures

Fiscal Year	Total Expenditures	Research Expenditures	Share
1982	Y47,562.1	Y1,448.0	3.0%
1983	50,839.4	1,448.9	2.8
1984	51,513.4	1,477.6	2.9
1985	53,222.9	1,521.6	2.9
1986	53,824.8	1,599.0	3.0
1987	58,241.2	1,655.0	2.8
1988	61,851.7	1,715.7	2.8
1989	66,311.9	1,814.8	2.7
1990	69,651.2	1,920.9	2.8
1991*	70,347.4	2,022.6	2.9

b. As a Share of Discretionary Expenditures

Fiscal Year	Total Expenditures	Research Expenditures	Share
1982	Y33,120.0	Y1,448.0	4.4%
1983	35,356.8	1,448.9	4.1
1984	33,244.5	1,477.6	4.4
1985	33,352.3	1,521.6	4.6
1986	33,425.7	1,599.0	4.8
1987	35,276.5	1,655.0	4.7
1988	36,789.8	1,715.7	4.6
1989	39,257.4	1,814.8	4.6
1990	39,271.0	1,920.9	5.0
1991*	37,238.2	2,022.6	5.4

*Initial budget.

Source: Ministry of Finance

has kept pace with the expansion of total spending (its share has varied only marginally) but has outrun discretionary spending (as shown by its gradually increasing share). As important as R&D spending is, it is not a top priority, however. Outlays for foreign aid, defense and public works all have enjoyed higher growth rates than R&D in the past and are likely to continue to do so in the future.

When government R&D spending is broken down by agency for the most recent two fiscal years (see Tables 5 and 6), FY 1991 appears to come up short of the previous year's mark. Overall R&D spending growth for FY 1991 initially was budgeted at 5.3 percent, less than FY 1990's final mark of 5.7 percent. Unlike previous years, when the pattern of outlays was chaotic, the direction of

Table 5: Japanese Government R&D Expenditures, Revised FY 1990

(in millions of yen and percentage change)

	Science Promotion	Energy and Other Research	Special Research*	Total
Diet	Y523	Y0	Y0	Y523
	0.0%	--	--	0.0%
Japan Technology Council	0	951	0	951
	--	9.7%	--	9.7%
Police Agency	1,096	0	0	1,096
	3.4%	--	--	3.4%
Hokkaido Development Agency	144	0	0	144
	1.4%	--	--	1.4%
Defense Agency	0	104,268	0	104,268
	--	12.0%	--	12.0%
Economic Planning Agency	825	0	0	825
	5.8%	--	--	5.8%
Science and Technology Agency	203,648	164,933	124,937	493,518
	8.2%	-0.7%	12.4%	6.0%
Environment Agency	9,141	0	0	9,141
	16.9%	--	--	16.9%
Justice Ministry	950	0	0	950
	7.8%	--	--	7.8%
Foreign Ministry	0	7,095	0	7,095
	--	10.7%	--	10.7%
Finance Ministry	373	0	730	1,102
	2.7%	--	-1.1%	0.1%
Education Ministry	72,770	129,907	689,721	892,398
	9.1%	1.2%	4.9%	4.7%
Health Ministry	38,830	1,319	10,092	51,241
	6.8%	13.5%	2.3%	5.9%
Agriculture Ministry	65,298	2,544	3,300	71,141
	2.9%	11.2%	-2.9%	2.9%
International Trade and Industry Ministry	55,940	12,912	181,340	250,192
	-0.4%	-5.3%	10.4%	6.9%
Transportation Ministry	13,184	3,311	1,039	17,534
	-1.2%	53.2%	13.3%	6.8%
Posts and Telecommunications Ministry	4,561	189	26,543	31,292
	2.9%	79.8%	0.5%	1.1%
Labor Ministry	633	38	3,522	4,193
	3.0%	5,483.6%	-11.0%	-8.1%
Construction Ministry	5,668	454	0	6,122
	2.8%	45.3%	--	5.1%
Home Affairs Ministry	582	0	0	582
	1.8%	--	--	1.8%
Total	474,166	427,921	1,016,222	1,918,309
	6.1%	3.3%	6.6%	5.7%

*Column adds to more than the total because of double-counting of budgets for projects shared by more than one agency.

Source: Japan Society for the Promotion of Science, Japanese Scientific Monthly, July 1991.

Table 6: Japanese Government R&D Expenditures, Initial FY 1991

(in millions of yen and percentage change)

	Science Promotion	Energy and Other Research	Special Research*	Total
Diet	Y533	Y0	Y0	Y533
	0.0%	--	--	0.0%
Japan Technology Council	0	1,051	0	1,051
	--	10.5%	--	10.5%
Police Agency	1,143	0	0	1,143
	8.3%	--	--	8.4%
Hokkaido Development Agency	148	0	0	148
	-0.5%	--	--	-0.5%
Defense Agency	0	115,045	0	115,045
	--	10.3%	--	10.3%
Economic Planning Agency	850	0	0	850
	5.1%	--	--	5.1%
Science and Technology Agency	223,942	165,575	133,045	522,561
	9.3%	0.4%	6.5%	5.6%
Environment Agency	10,900	0	0	10,900
	18.3%	--	--	18.3%
Justice Ministry	1,006	0	0	1,006
	7.1%	--	--	7.1%
Foreign Ministry	0	8,160	0	8,160
	--	15.0%	--	15.0%
Finance Ministry	381	0	811	1,193
	6.4%	--	11.2%	9.7%
Education Ministry	76,576	131,030	728,718	936,324
	2.5%	0.9%	5.7%	4.7%
Health Ministry	42,278	2,159	11,707	56,144
	8.9%	63.7%	5.5%	9.6%
Agriculture Ministry	67,450	2,807	3,300	73,577
	5.1%	6.2%	0.0%	4.9%
International Trade and Industry Ministry	56,465	13,843	185,605	255,913
	1.6%	4.4%	1.6%	1.7%
Transportation Ministry	13,443	5,926	1,145	20,514
	2.9%	79.0%	11.0%	17.9%
Posts and Telecommunications Ministry	5,072	232	28,600	33,904
	13.5%	22.6%	10.0%	10.6%
Labor Ministry	673	6	4,367	5,046
	6.8%	-83.6%	24.0%	20.4%
Construction Ministry	5,892	732	0	6,624
	6.6%	61.2%	--	10.8%
Home Affairs Ministry	616	0	0	616
	9.1%	--	--	9.1%
Total	507,368	446,565	1,068,698	2,022,631
	6.7%	4.2%	5.1%	5.3%

*Column adds to more than the total because of double-counting of budgets for projects shared by more than one agency.

Source: Japan Society for the Promotion of Science, Japanese Scientific Monthly, July 1991.

spending in FY 1991 is more evenly upward. Only two items have faced reductions in the current fiscal year, compared with five in FY 1990. Agencies that logically have a strong claim to government R&D funds, such as the Science and Technology Agency and the Ministry of International Trade and Industry, show smaller gains in FY 1991 compared to the previous year. The Education Ministry's unchanged growth rate disappointed many observers because the ministry has pledged both to upgrade research at the nation's universities and to bolster basic research, a task that will require significant infusions of money. For a handful of other agencies, FY 1991 portends a prosperous year, typified by the Labor Ministry (up 20.4 percent after dropping the previous year), the Environment Agency (18.3 percent) and the Transportation Ministry (17.9 percent). The FY 1991 increase inked in for the Environment Agency is noteworthy as it represents the second straight significant gain. The Japan Defense Agency's R&D budget also continues to lead a charmed life, with FY 1991's growth rate still in double digits. JDA is planning to double R&D's share of its budget from 2.5 percent to 5 percent by FY 1995. Ideally this would mean that defense-related research would rise even if overall defense spending growth slows or halts. The end of the Cold War and new prospects for warmer relations between Japan and the new Soviet Union, however, may put a damper on defense-related R&D in future years.

A better idea of each agency's priorities can be derived from a detailed look at FY 1990-FY 1991 spending plans (see Table 7). In general, government planners continue to hew to well-established courses. Nuclear power remains high on the list of priorities, with STA, MITI and the Foreign Ministry devoting a steady stream of resources toward this area. The promotion of new technologies -- such as STA's fund for innovative and basic research, MITI's large-scale industrial technology program and the Ministry of Transportation's magnetic levitation research -- also accounts for a significant share of spending.

Basic research, which includes MITI's Human Frontiers Science Program and the Basic Technology Promotion Center (a joint venture of MITI and the Ministry of Posts and Telecommunications), also gained ground in FY 1991. Although the Education Ministry's overall FY 1991 budget showed growth equal that of FY 1990, more money is to be channeled into university research programs this year, as shown by the 5.7 percent boost in spending for this purpose. Grant money for university researchers, however, shows only a scant gain of 0.9 percent. A dominant theme in Japan's basic research program appears to be internationalism -- either inviting foreign researchers to come to Japan or forming joint projects to carry out research around the globe.

Environmental research clearly is gathering momentum; most agencies boosted funding for their initiatives in this area in FY 1991. STA, in particular, is carving out a leading role in this field; its Green Planet Project and environmental research budget together are nearly six times larger than the Environment Agency's corresponding outlays (those not associated with disaster prevention). Even MITI's two-year-old Global Environment Industrial Technology Institute has a budget almost as big as the nondisaster-oriented research in the Environment Agency (Y6,748 million or $50 million versus Y7,677 million or $56.9 million). This budget juggling has led some skeptics to question whether bureaucrats truly are interested in green policies or are hitching a ride on the environmental bandwagon to boost their budgets.

Overall, public spending has followed the tried-and-true approach that helped foster the nation's economic vigor, with funds focused on developing

Table 7: Expenditures on Selected Science Programs by Agency, FY 1990-FY 1991

(in millions of yen)

	FY 1990	FY 1991
Japan Defense Agency		
Technology development	Y104,268	Y115,045
Science and Technology Agency		
Promotion of innovative and basic technology	7,637	10,127
Green Planet Project (global warming)	4,708	10,306
Human Frontiers Science Program	1,872	2,194
Science and technology promotion	11,843	14,397
Science policy administration	10,837	11,189
Nuclear energy research	296,215	306,435
Outerspace research	119,416	131,769
Ocean technology development	9,864	10,666
Environmental, planetary research	26,133	35,662
Materials research	11,958	13,548
Superconducting materials	3,460	3,087
Intelligent materials	0	271
Life sciences research	16,441	18,976
Optical technology research	10,688	9,329
Environment Agency		
National Environment Research Institute	4,899	5,977
Global environmental research	1,200	1,700
National Disaster Prevention Institute	1,928	1,928
Disaster prevention survey	1,015	1,186
Foreign Ministry		
International Atomic Energy Commission	2,956	3,604
OECD Nuclear Power Committee	200	324
Finance Ministry		
Brewing Research Institute	358	381
Printing Agency Research Institute	730	811
Education Ministry		
Research grants	55,800	58,900
Japan Technology Promotion Council grants	6,148	6,661
University research programs	689,721	728,718
National university research grants	129,907	131,029
Health Ministry		
Agency research	15,706	16,926
Research grants	18,844	20,391
Pharmaceutical research	2,300	2,300
Health science research	6,467	7,426
Cancer research projects	3,254	3,352
International cancer research	170	176
Medical and drug information system	242	149
Agriculture Ministry		
Agency research laboratories (including 29 agricultural research centers)	59,221	62,421
Large-scale projects	1,302	1,316
Biotechnology development	1,565	1,820
Livestock research	4,171	4,222
Tropical agriculture research	672	716

Table 7 (continued)

(in millions of yen)

	FY 1989	FY 1990
Red tide research	278	265
Food product technology	589	642
International Trade and Industry Ministry		
Agency research (including 16 research centers)	39,027	41,026
Large-scale industrial technology projects	13,120	13,460
Basic computer technology development	3,465	3,083
Basic Technology Promotion Center	26,000	28,600
Next-generation basic technology projects	7,463	7,869
New energy technology development projects	27,475	24,817
Energy conservation projects	11,119	11,487
Nuclear energy development projects	29,772	28,724
Human Frontiers Science Program	1,337	1,515
International aircraft development	3,817	3,670
Global Environment Industrial Technology Institute	6,070	6,748
Small business technology improvement	1,612	1,612
Transportation Ministry		
Agency research (including five ship technology centers)	8,452	9,088
Geostationary weather satellite management	2,130	2,154
Geostationary weather satellite launches	3,272	2,946
Magnetic levitation train technology	2,227	4,705
Next-generation ship technology	800	936
Posts and Telecommunications Ministry		
Electrotechnical laboratories	4,468	5,072
Communications Frontier Research	389	470
Basic Technology Promotion Center	26,000	28,600
Labor Ministry		
Agency research	2,432	3,152
Industrial safety research	1,354	2,043
Japan Bioassay Research Center	1,313	1,363
Construction Ministry		
Agency research (including one engineering center)	4,778	5,055
Construction technology research	734	765

Source: Japan Society for the Promotion of Science, Japanese Scientific Monthly, July 1991.

precommercial know-how. This has been particularly true in areas that are considered too risky for private companies to bear the full costs on their own, such as space development. New facets of government R&D are providing increased support for basic and international research ("international" in that it either involves foreign participation or is aimed at global issues). In light of the fact that most of these new categories fared well in the FY 1991 budget, Tokyo appears to be preparing new channels that will direct the flow of government R&D spending well into the next century. The success or failure of these new directions, however, is not dependent on funding alone. Support from the private sector and foreigners will be equally important factors.

Private Spending - The data in Tables 1 and 2 underscore the increasingly dominant role of private R&D in Japan. Companies outspent the government four-to-one in FY 1989, a ratio that probably tipped even more toward the private sector's favor the following fiscal year, based on reports of double-digit growth in capital investment. Intense competition -- both domestic and foreign -- has stimulated Japanese companies to adopt a strong technology development program as a key element of their business strategies. Technology drives down production costs, can pare the size as well as energy consumption of products, differentiates products from those of competitors' via innovative features, and leads to new products and markets. While not completely immune to corporate planners' profit motives, R&D budgets have been spared the full blow of the cost cutter's axe during slow business periods because R&D is considered crucial to a firm's future competitiveness. Record corporate profits during the late 1980s can be traced, at least partly, to strong R&D spending in previous years. Thanks to these record profits R&D budgets have continued to expand rapidly, positioning Japanese firms for leadership in many areas through the 1990s.

The latest government data on private R&D extend only through FY 1989 but still show a general surge in spending, except in agriculture (see Table 8). Whereas 11 sectors recorded single-digit increases in FY 1988, only six industries registered single-digit gains the following year. Although the two industries that cut R&D spending in FY 1989 did so sharply (agriculture off 46.3 percent and mining by 12.5 percent), these sectors account for less than 0.4 percent of total private outlays. It is not clear from the government survey why these two sectors slashed research spending, but they have a history of volatility. The great majority of the 30-odd industries surveyed by the Management and Coordination Agency turned in double-digit performances, with standouts worth noting at both ends of the spectrum. Among the industries that nearly doubled or tripled the rate of R&D spending growth were: publishing, petroleum, plastics, fabricated metal products and nonelectric machinery. Conversely, eight sectors slowed their rate of spending increase; these included pulp and paper as well as nonferrous metals. Perhaps most significant, the industries where Japan is already a strong international competitor -- textiles, chemicals, nonelectric and electric machinery plus transportation equipment -- all showed solid gains. It is clear that Japanese firms have no intention of resting on their laurels in the technology race.

The commitment of Japanese management to R&D is obvious when it is expressed as a share of gross sales (see Table 9). Over the past 11 years, only one sector -- agriculture -- recorded a lower R&D-to-gross sales ratio at the end of the period than at the beginning. Of particular note are the industries once considered technologically mature that have transformed gradually into dynamic high technology industries. Japan's textile industry, for example, continues to roll out new products with unique qualities, such as temperature-sensitive coloration, shape-memory retention, absorption or reflection of solar energy, and unusual textures and finishes. These products are a direct result of the industry doubling its ratio of R&D to sales over the past decade. This ratio also has risen strongly in industries traditionally considered technology-intensive, such as communications and electronics, pharmaceuticals, and precision machinery.

Since private R&D is where most of the action is taking place in Japan, it is not surprising that international pressure is building for companies to

Table 8: Japan's R&D Expenditures by Industry, FY 1988-FY 1989

(in billions of yen and percentage change)

	FY 1988		FY 1989	
	Total	Change	Total	Change
Agriculture	Y8.2	41.4%	Y4.4	-46.3%
Mining	28.1	44.1	24.6	-12.5
Construction	148.5	15.7	185.1	24.7
Manufacturing	6,754.6	10.7	7,706.2	14.1
Food Products	179.3	0.1	203.6	13.5
Textiles	72.8	9.5	81.3	11.6
Pulp and Paper	42.8	27.8	45.5	6.3
Publishing and Printing	25.4	17.1	33.7	33.0
Chemicals	1,190.2	8.6	1,313.9	10.4
Industrial Chemicals and Synthetic Fibers	501.5	10.8	552.0	10.1
Oils and Paints	116.3	4.4	134.5	15.6
Pharmaceuticals	416.2	9.3	456.0	9.5
Other	156.2	3.3	171.4	9.7
Petroleum and Coal Products	75.0	6.8	84.2	12.3
Plastic Products	90.9	5.8	120.8	32.8
Rubber Products	101.5	19.1	111.8	10.1
Nonmetallic Mineral Products	198.6	11.6	221.4	11.5
Steel	249.7	1.8	268.1	7.4
Nonferrous Metals	120.3	15.2	127.0	5.6
Fabricated Metal Products	89.6	-5.5	109.3	22.0
Nonelectric Machinery	451.0	7.7	559.0	23.9
Electric Machinery	2,451.6	13.3	2,808.1	14.5
Communications and Electronics Equipment	1,709.8	14.2	1,941.7	13.6
Other	741.8	11.4	866.4	16.8
Transportation Equipment	1,086.4	12.0	1,244.6	14.6
Motor Vehicles	932.4	14.4	1,087.2	16.6
Other	154.0	-0.5	157.4	2.2
Precision Machinery	238.8	16.9	266.1	11.5
Other	90.8	6.9	107.8	18.7
Transportation, Communications and Utilities	279.9	16.9	313.5	12.0
Total	7,219.3	11.2	8,233.8	14.1

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

share their technology. Japanese companies are faced with two demands: increase funding for basic research (which is to be freely shared) and transfer more technology to foreign partners. As mentioned above, the business sector moved more of its R&D outlays in FY 1989 to developmental research and away from basic and applied work. Table 10 shows that while the overall figures may have moved in one direction, the allocations by individual industries reveal a more haphazard pattern of spending decisions. With regard to basic research,

Table 9: Japan's Ratio of Corporate R&D Expenditures to Gross Sales by Industry, FY 1978-FY 1989

(in percent)

Industry	FY 1978	FY 1983	FY 1988	FY 1989
Agriculture	0.60%	0.26%	0.38%	0.21%
Mining	0.54	0.59	1.27	0.94
Construction	0.42	0.53	0.49	0.52
Manufacturing	1.82	2.31	3.15	3.29
Food Products	0.51	0.70	0.89	1.07
Textiles	0.77	0.90	1.50	1.71
Pulp and Paper	0.49	0.63	0.87	0.79
Publishing and Printing	0.36	0.43	0.63	0.71
Chemicals	2.71	3.34	4.63	4.84
Industrial Chemicals and Synthetic Fibers	1.92	2.32	3.92	4.09
Oils and Paints	2.73	2.83	3.74	3.93
Pharmaceuticals	5.00	6.59	6.94	7.50
Other	3.03	3.04	4.11	4.11
Petroleum and Coal Products	0.27	0.26	0.83	0.72
Plastic Products	n.a.	n.a.	2.21	2.73
Rubber Products	2.60	2.40	3.19	3.25
Nonmetallic Mineral Products	1.29	1.82	2.73	2.75
Steel	1.08	1.60	2.13	2.21
Nonferrous Metals	1.00	1.49	2.00	1.91
Fabricated Metal Products	1.08	1.31	1.48	1.36
Nonelectric Machinery	1.93	2.57	2.60	2.83
Electric Machinery	3.74	4.70	5.53	5.89
Communications and Electronics Equipment	3.89	4.85	5.66	6.10
Other	3.59	4.40	5.25	5.47
Transportation Equipment	2.44	2.66	3.31	3.40
Motor Vehicles	2.60	2.89	3.31	3.48
Other	1.90	1.86	3.31	2.93
Precision Machinery	3.15	4.02	4.85	5.16
Other	1.16*	1.30*	1.14	1.19
Transportation, Communications and Utilities	0.35	0.39	0.95	1.06
All Industry Average	1.57	1.97	2.60	2.72

*Includes plastic products.

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

exactly as many industries cut the proportion of their spending in this area (13) as increased it between FY 1988 and FY 1989. Despite an overall increase in the private sector's share of developmental research, more sectors reduced the share of funds for this category than increased it in FY 1989 by a solid margin (15 to 11). The distribution of spending emphasis is predictable, with

Table 10: Japan's Corporate R&D Expenditures by Purpose, FY 1988-FY 1989

(in percent of total sectoral spending)

Industry	Basic Research		Applied Research		Developmental Research	
	1988	1989	1988	1989	1988	1989
Agriculture	5.4%	8.8%	33.4%	30.9%	61.2%	60.3%
Mining	23.0	17.0	31.3	28.1	45.7	54.9
Construction	5.7	6.1	29.7	22.8	64.6	71.1
Manufacturing	6.3	6.4	21.2	21.0	72.5	72.6
Food Products	10.1	12.1	31.7	32.3	58.2	55.6
Textiles	6.2	6.1	30.6	26.9	63.2	67.0
Pulp and Paper	5.1	4.2	31.1	26.0	63.8	69.8
Publishing and Printing	2.8	5.9	29.9	45.3	67.3	48.8
Chemicals	11.9	13.7	29.4	27.8	58.7	58.5
Industrial Chemicals and Synthetic Fibers	8.8	10.7	32.3	30.0	58.9	59.4
Oils and Paints	5.2	4.4	34.9	33.3	60.0	62.2
Pharmaceuticals	18.8	20.9	28.3	26.8	53.0	52.3
Other	8.7	11.4	19.1	19.1	72.2	69.5
Petroleum and Coal Products	13.3	11.1	20.9	24.3	65.9	64.6
Plastic Products	6.8	3.0	28.5	25.4	64.7	71.6
Rubber Products	4.8	4.1	17.0	19.8	78.2	76.2
Nonmetallic Mineral Products	7.6	8.3	20.1	22.4	72.3	69.3
Steel	9.8	10.8	24.5	25.0	65.7	64.2
Nonferrous Metals	3.5	4.3	28.9	29.2	67.6	66.5
Fabricated Metal Products	2.2	2.3	13.3	16.1	84.5	81.6
Nonelectric Machinery	4.4	3.9	20.4	21.0	75.2	75.0
Electric Machinery	4.3	4.1	19.1	18.7	76.6	77.2
Communications and Electronics Equipment	4.2	3.9	18.6	18.5	77.1	77.6
Other	4.5	4.7	20.1	19.0	75.4	76.3
Transportation Equipment	4.7	4.1	14.3	13.4	81.0	82.5
Motor Vehicles	4.6	3.9	12.9	11.8	82.5	84.2
Other	5.5	5.3	22.8	24.3	71.7	70.4
Precision Machinery	4.2	4.3	18.6	22.2	77.2	73.5
Other	4.3	4.2	19.9	22.1	75.8	73.7
Transportation, Communications and Utilities	12.5	5.5	28.2	32.1	59.3	62.4
All Industry Average	6.6	6.4	21.7	21.5	71.7	72.2

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

industries such as petroleum and chemicals (pharmaceuticals, in particular) devoting a relatively high proportion of their R&D budgets to basic research, while machinery and equipment makers have concentrated their monies on development.

Technology Trade - Perhaps the area in which the international community has the highest expectations of Japan is in technology trade. Japanese companies must combat their reputation as global technology scavengers and hoarders before their recent offers of technological assistance will be viewed with less suspicion by foreigners. The biggest obstacle to greater technology transfers is linked closely to the private sector's leading role in Japanese R&D, which means that much of the most desirable technology is in the hands of private companies, not the government. Private firms understandably are loathe to disclose potentially important know-how to competitors and even less inclined to do so without adequate licensing or royalty fees. While foreigners may feel Japan is indebted to the rest of the free-market world for relatively unlimited access to foreign technology that contributed to the island nation's commercial success, Japanese argue that their success is due as much to their own efforts as to the foreign technology, which they readily admit they absorbed. In addition, Japanese argue that their technology-gathering was aboveboard and paid for via licensing fees and royalties. Nevertheless, Tokyo has committed Japan to becoming a net contributor of technology, particularly to developing nations.

The latest government data on technology flows indicate that Japan is making progress toward this goal. Exports of technology in FY 1989 surpassed imports in the number of transactions and nearly exceeded the total value of imports (see Tables 11 and 12). When only new technology transactions (excluding payments or renewals of previous deals) are considered, the picture is unambiguous, with exports easily topping imports in both number and value terms. In fact, in numbers of cases it is clear that Japan has been a net exporter of new technology for some years.

Table 11: Japan's Technology Imports, FY 1975-FY 1989

(number of approved cases and value in billions of yen)

	Cases		Value	
	Total	Of Which New:	Total	Of Which New:
FY 1975	6,766	796	169.1	Y13.3
FY 1976	6,050	632	177.3	17.9
FY 1977	6,659	685	190.1	16.9
FY 1978	6,573	936	192.1	38.2
FY 1979	7,012	1,020	241.0	26.8
FY 1980	7,248	919	239.5	27.7
FY 1981	7,207	844	259.6	24.9
FY 1982	6,936	929	282.6	44.4
FY 1983	7,839	1,073	279.3	42.4
FY 1984	7,316	982	281.4	31.8
FY 1985	7,679	1,245	293.2	33.3
FY 1986	7,494	1,141	260.6	33.6
FY 1987	7,373	813	283.2	56.2
FY 1988	8,356	1,382	312.2	54.6
FY 1989	7,109	1,056	329.9	48.4

The picture becomes sharper when the data are broken down by industry (see Table 13). The manufacturing sector, which naturally accounts for the bulk of activity, partially reversed its position between FY 1988, when it was a net

Table 12: Japan's Technology Exports, FY 1975-FY 1989

(number of approved cases and value in billions of yen)

	Cases		Value	
	Total	Of Which New:	Total	Of Which New:
FY 1975	2,811	1,073	66.6	Y18.9
FY 1976	2,767	775	83.4	27.0
FY 1977	2,880	897	93.3	36.3
FY 1978	3,157	1,063	122.0	47.1
FY 1979	3,667	1,087	133.1	52.1
FY 1980	4,103	1,237	159.6	74.3
FY 1981	4,877	2,017	175.1	70.8
FY 1982	4,738	1,970	184.9	63.3
FY 1983	6,403	2,494	240.9	74.9
FY 1984	5,426	1,824	277.5	90.9
FY 1985	5,885	2,099	234.2	73.3
FY 1986	5,469	1,730	224.1	51.8
FY 1987	5,955	1,655	215.6	44.8
FY 1988	6,352	1,850	246.3	47.4
FY 1989	7,559	2,086	329.3	66.6

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

importer of technology in both numerical and value terms, and FY 1989, when it became a net exporter at least in terms of cases. The FY 1989 turnaround resulted from both a surge in the number and the value of exports and a sharp fall in imports. Manufacturers of fabricated metal products and, in particular, firms in the textile and synthetic fibers industries increased their technology licensing activities in FY 1989. Interestingly, however, the amount of royalties and fees earned by these sectors increased proportionately only for synthetic fibers.

On the import side, the downward trend spread across nearly two out of every three sectors. Some sectors, in fact, recorded surprisingly sharp drops. The electronics sector, for example, accounted for the bulk of the decline between FY 1988 and FY 1989 when the number of its import contracts dropped from 2,416 to 1,376. (Paradoxically, the value of these contracts rose from Y79.3 billion or $587.4 million to Y92 billion or $681.5 million.)

When technology trade is analyzed by country (see Table 14), the pattern is mixed. Exports of Japanese technology to Asian nations, the United States and Western Europe generally exhibited good gains between FY 1986 and FY 1989. Obtaining Japanese technology is a top goal of the rapidly industrializing economies of Asia. South Korea has been particularly vocal on this issue; this may have been one factor behind the big jump in Japanese technology exports to that nation in FY 1989. Other Asian countries, including China and India, also are tapping in to Japanese technology with increasing frequency. Transfers of Japanese know-how to its Western industrialized allies also rose solidly in FY 1989, particularly to the United States.

Imports of technology slowed in FY 1989, particularly from the United States, although interest in German and British know-how revived somewhat that year. Contracts to obtain U.S. technology dropped by almost 27 percent in

Table 13: Japan's Corporate Technology Trade by Industry, FY 1988-FY 1989

(number of cases and value in billions of yen)

	FY 1988				FY 1989			
	Exports		Imports		Exports		Imports	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Total	6,352	Y246.3	8,356	Y312.2	7,559	Y329.3	7,109	Y329.9
Agriculture	8	0.1	5	0.0	5	0.0	1	0.0
Mining	11	0.1	35	0.1	9	0.0	27	0.3
Construction	387	16.8	171	1.0	219	12.4	290	2.0
Manufacturing	5,887	228.6	8,119	309.5	7,286	316.2	6,776	326.9
Food Products	118	5.8	123	13.4	142	8.3	93	8.5
Textiles	191	4.4	143	4.9	358	4.6	95	4.8
Pulp and Paper	29	0.5	27	0.8	36	0.6	21	1.3
Publishing	29	0.4	70	0.9	33	0.4	91	1.6
Chemicals	1,185	48.1	1,044	50.3	1,297	53.6	942	56.9
Synthetic Fibers	561	27.1	446	20.5	610	29.5	473	23.2
Fertilizers	241	3.1	259	4.3	253	3.8	136	5.0
Pharmaceuticals	294	16.3	231	18.2	317	18.9	252	21.5
Other	89	1.6	108	7.3	117	1.5	81	7.2
Petroleum and Coal Products	12	0.2	103	2.2	14	0.5	113	3.8
Plastic Products	95	1.3	84	1.2	94	1.2	89	1.3
Rubber Products	93	2.9	105	3.7	174	4.8	108	3.8
Nonmetallic Mineral Products	277	5.7	154	3.7	252	9.0	174	4.1
Steel	422	10.8	359	7.9	551	21.6	320	4.8
Nonferrous Metals	207	2.0	195	14.6	267	7.1	221	10.7
Fabricated Metal Products	155	1.1	172	2.2	409	2.0	154	2.3
Nonelectric Machinery	700	10.8	1,112	22.6	777	13.2	1,270	33.0
Electric Machinery	1,476	68.8	2,889	113.8	1,669	86.7	1,825	120.6
Machine Tools	670	21.0	473	34.5	689	28.2	449	28.5
Electronics	806	47.7	2,416	79.3	980	58.5	1,376	92.0
Transportation Equipment	684	58.4	789	52.0	777	87.1	819	54.9
Motor Vehicles	447	54.2	260	6.6	525	83.0	250	7.2
Other	237	4.2	529	45.4	252	4.1	569	47.7
Precision Machinery	114	4.6	255	7.3	320	12.6	290	8.3
Other	100	2.8	495	8.1	116	2.9	151	6.3
Transportation, Communications and Utilities	59	0.7	26	1.6	40	0.6	15	0.7

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

Table 14: Japan's Corporate Technology Trade by Country, FY 1986-FY 1989

(number of cases and value in billions of yen)

a. Exports

	FY 1986		FY 1987		FY 1988		FY 1989	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Asia	2,748	Y86.5	3,152	Y86.4	3,264	Y101.4	3,965	Y128.9
China	454	19.7	405	9.4	339	8.4	473	8.1
Taiwan	532	8.5	590	12.3	660	13.2	609	16.3
South Korea	732	21.1	816	27.5	888	30.6	1,350	38.5
Thailand	203	5.4	294	7.3	331	9.9	364	17.6
Philippines	89	0.6	133	2.0	n.a.	n.a.	n.a.	n.a.
Indonesia	196	4.4	182	3.2	228	13.6	304	10.9
Malaysia	128	3.2	147	3.1	128	4.0	221	6.3
India	196	4.4	182	3.2	211	5.4	245	6.2
West Asia	94	10.5	52	1.6	59	2.3	72	2.4
North America	1,006	62.3	1,058	72.5	1,225	77.0	1,671	115.1
United States	869	57.7	912	65.9	1,080	71.1	1,445	107.7
South America	216	5.2	198	4.5	195	4.4	182	4.6
Brazil	127	3.8	107	2.5	114	2.5	n.a.	n.a.
Europe	1,040	43.6	1,184	40.3	1,281	49.3	1,342	65.1
Great Britain	161	7.6	190	10.6	221	13.9	251	20.0
West Germany	247	7.8	297	7.4	301	10.7	328	13.7
France	145	5.9	162	5.2	137	4.4	149	7.1
Netherlands	41	2.5	53	2.1	86	2.2	71	2.1
Switzerland	53	3.8	52	2.3	63	1.4	51	1.6
Africa	189	9.5	147	5.0	141	6.0	136	6.8
Oceania	176	6.6	164	5.3	187	5.9	191	6.5
Australia	139	5.8	116	4.2	134	5.2	143	5.7

b. Imports

	FY 1986		FY 1987		FY 1988		FY 1989	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Asia	15	Y0.3	12	Y0.1	29	Y0.2	26	Y0.3
China	4	*	2	*	0	0.0	3	*
Taiwan	0	0.0	2	*	15	0.0	4	*
South Korea	4	*	4	*	4	*	7	0.1
West Asia	94	10.5	2	*	0	0.0	8	0.1
North America	4,926	174.6	4,747	179.3	5,591	198.1	4,118	210.7
United States	4,825	173.8	4,667	178.6	5,495	196.9	4,029	209.5
South America	4	*	3	*	1	*	1	*
Europe	2,516	85.1	2,568	103.4	2,706	113.6	2,903	118.2
West Germany	903	20.7	847	21.4	835	18.4	1,104	24.3
Great Britain	477	13.0	512	10.3	451	9.3	487	10.8
France	298	7.3	313	22.1	432	26.2	354	25.5
Switzerland	241	17.5	273	17.4	277	18.4	256	19.0
Netherlands	163	15.6	173	20.8	182	27.6	202	21.1
Africa	3	*	3	*	0	0.0	0	0.0
Oceania	28	0.4	38	0.3	29	0.3	53	0.7

*Less than Y50 million.

Source: Management and Coordination Agency, Report on the Survey of Research and Development.

numerical terms in FY 1989 but were up slightly in value terms. Despite these shifts, Japan's technology trade with both the United States and Germany remains deeply in the red.

Perhaps more troubling to developing nations outside of Asia is the lack of attention paid by Japan to this area, according to FY 1989 data. Technology exports to West Asia, South America and Africa have declined over the past four years and show no sign of turning around. Unless this trend reverses, Japan's drive to become a leading source of technology for global development will come up short.

A price analysis of Japan's technology trade reveals some interesting points. The average values of export and import contracts have dogged each other closely over the FY 1975-1989 period. In FY 1975 the average nominal cost of a technology import contract was Y25 million ($185,200) and the cost of an export deal was Y23.7 million ($175,600). The average cost of an import contract rose steadily until FY 1988 when it reached Y37.4 million ($277,000) and then jumped to Y46.4 million ($343,700) in FY 1989. On the export side, the average price followed a similar upward slope, hitting Y43.6 million ($323,000) by FY 1989. Unusual years are evident on both sides of the ledger. In FY 1982 the average import deal jumped from Y36 million ($266,700) to Y40.7 million ($301,500) before dropping back to Y35.6 million ($263,700) the following year. During the FY 1983-FY 1985 period the average value of an export contract rose from Y37.6 million ($278,500) to Y51.1 million ($378,500) then fell to Y39.8 million ($294,800).

Over the entire 15-year period, import contracts averaged Y35 million ($259,300) while export agreements were valued at an average Y37.4 million ($277,000). The results do not change significantly when only new cases of technology transfer are considered; the average new export contract was worth Y36.1 million ($267,400) and the corresponding figure for new imports was Y35.1 million ($260,000). The average price of new technology contracts did show greater year-to-year variability for both exports and imports. (It should be pointed out that Tokyo has no official policy on rates for royalties and license fees. As is the practice in the United States and Europe, decisions by the parties involved in technology transfer negotiations determine prices.) While the greater average value of export contracts speaks well for Japanese business acumen, it raises questions about Tokyo's altruism, which has been suggested by its leaders' espousal of a goal of paying back to the world a perceived technology debt.

New Goals: A Progress Report

The debate in Japan over the nation's new international responsibilities is far from over but its impact on R&D policies already is clear. Government officials have set new goals for Japanese R&D that already are bringing about changes in spending and policies. At present Tokyo has enumerated four new yardsticks by which its R&D policies will be measured: fostering basic research; focusing on environmental issues; transferring technology to developing countries; and internationalizing its R&D system. These four goals often intertwine, sometimes creating positive synergy but also generating problems. Japanese aid officials, for example, are interested in transferring technology to developing nations that not only will make economic sense but environmental sense as well. Conversely, several of Tokyo's proposals for joint international research (applied and basic) have generated controversy not only overseas but within the Japanese government as well.

Environmental considerations - The previous analysis of government R&D spending by agency already has shown that "green" projects are the latest fad among R&D planners. Substantive projects are being drawn up and implemented as quickly as the budget process allows. The New Energy and Industrial Technology Development Organization (NEDO), a semigovernmental agency affiliated with MITI, added two projects to its Global Environment Technology Program for FY 1991. One seeks to develop methods to manufacture recyclable metal products using alternative energy sources; the other focuses on technology to produce hydrogen from microorganisms instead of fossil fuels. Other projects sponsored by STA and the Environment Agency are aimed at developing alternative energy sources for small-scale use (household-sized solar energy units, for example) and pollution control technologies.

Advocates of nuclear power also have taken up the green banner to support both research on and construction of nuclear power plants. While some environmentalists view this as a perversion of their cause, others point out that Japan must make tough decisions if it is to fulfill a pledge to reduce its output of gases thought to contribute to a greenhouse-like warming of the earth.

Technology transfer - Japan feels it has much to offer developing countries in the way of technology. Because Japan, like many developing countries, is resource poor, it has developed a wealth of appropriate technologies. Small-scale manufacturing and energy systems are just two examples. The Foreign Ministry's Japan International Cooperation Agency and MITI's Japan Overseas Cooperation Volunteers Program (which is modeled after the U.S. Peace Corps) are the main conduits for sending Japanese experts overseas (see JEI Report No. 43A, November 9, 1990).

The primary obstacle to a greater flow of technology from Japan to developing countries lies not with the amount or type of know-how available. Rather, the human/administrative side of the equation is lacking. Foremost, Japan's structure for administering foreign aid is understaffed (see JEI Report No. 47A, December 14, 1990). The number of people available to handle aid requests or travel overseas is limited, although growing. Encouraging private companies to bolster their technology transfer activities, particularly to poor developing countries, is a government priority, but progress has been slow.

Basic research - This is another area where reality lags behind Tokyo's rhetoric. Beginning in the mid-1980s, Japanese leaders have trumpeted the nation's new commitment to basic research. As shown by data on aggregate spending, however, it is clear that there has been little change, so far, in the division of Japan's R&D pie among basic, applied and developmental research. At a finer level of analysis, however, changes are taking place. Outlays for basic R&D programs, such as the Human Frontiers Science Project -- which explores basic body and brain functions, are expanding at a healthy pace. Initial budget requests for FY 1992 indicate that more attention will be paid to basic research, particularly by the Ministry of Education via the nation's universities. Even MITI, whose primary focus is industrial technology, is launching a handful of basic science projects, particularly in the materials science area.

From a foreign standpoint there also is a question about the fundamental nature of Japanese basic research. Even when industry claims it is conducting basic research, it is often planned or structured to yield a tangible benefit. Experiments in the emerging field of high-temperature superconductivity, for example, often yield prototype devices. This conceptualization of basic research also exists within government. MITI, for example, labels its Basic Technologies for Future Industries program as "fundamental science," yet its projects include development of next-generation computer software languages and quantum-level electronic devices. Japanese basic research often is aimed at finding basic uses for products, not at developing an understanding of the fundamental science that lies behind a particular phenomenon. The meaning of "basic" research, thus, is different in Japan than it is in the United States or Europe.

A major constraint keeping Japanese research priorities from shifting heavily in favor of basic research is the lack of a sufficiently powerful domestic constituency for this change. While private industry says it understands the need to promote basic research in Japan and around the globe, managers' focus on the bottom line naturally limits any actions. More voices within the government are supporting basic research, but they still are in the minority. It will take time for advocates of basic research to build a power base in Japan. Until then, Japanese basic research likely will be typified by a few high-visibility projects rather than a widespread effort.

Internationalization of Japanese R&D - Not only does internationalization imply external ties to foreign research resources and a research presence overseas but invitations to foreigners to engage in or become aware of work within Japan as well. Internal efforts include: the promotion of foreign research activities in Japan, wider dissemination of Japanese research and elimination of the distinctions between Japanese and foreign research activities, at least insofar as government calls for bids. Politics, both domestic and international, plays an inordinately large role in this area, causing problems and obstacles more often than not.

- Government efforts - Besides maintaining a host of bilateral cooperation pacts with major trading partners in a wide range of areas (energy and biological research, for example), Japan has launched several multinational projects. After a rocky start due to questions over funding and awarding of grants, Japan's Human Frontiers Science Program is attracting a growing number of applicants from around the world. In other areas, however, multilateral initiatives are not faring as well.

Japan's response to the Human Genome Project holds several lessons. The project, proposed by American scientists in 1985, is focused on mapping the genetic information of 30 individuals over the next 15 years at a cost of about $3 billion. With such a genetic roadmap scientists hope to open new frontiers for medical diagnostics and therapies. Japan's response to date, however, has been tepid at best. STA has budgeted about $7 million for the project, but other agencies have shown little interest. Even though a professor at Osaka University is a vice president in the Human Genome Organization (HUGO), which coordinates the international effort, he has been unable to generate any interest among public or private researchers. The assignment of a specific HUGO liaison role to a Tokyo University professor named to a scientific council that advises the prime minister may improve, but will not guarantee, the chances for increased or united Japanese action.

The U.S. attempt to gain more foreign investors and participants in its Superconducting Super Collider project raises other points for consideration.

The SSC will use an unprecedented number of superconducting magnets to smash together atomic particles in an effort to understand the fundamental nature of matter and energy. The giant accelerator will cost an estimated $8.5 billion ($11 billion by private estimates), and Washington has asked Japan and other allies to contribute in exchange for access to the facility. Not only is there no natural constituency for the SSC in Japan but a coalition has formed against it. Many Japanese scientists see the SSC as wasteful "big science," yielding meager results for a huge investment. Private firms can see no commercial or technical benefits arising from the SSC and therefore are not interested. Politicians and bureaucrats are unhappy with the project because the U.S. approach has been to ask for money without offering significant participation. With these groups arrayed against it, prospects for Japanese participation in the SSC are bleak.

Tokyo's latest international initiative, the Intelligent Manufacturing System, is moving ahead but at a far slower pace than expected. First proposed in late 1989 by the Ministry of International Trade and Industry, IMS is a universal computer standard that would replace standards that have been developed independently to handle various stages of production. MITI originally was willing to put up two-thirds of the 10-year project's estimated Y150 billion ($1.1 billion) price tag and actively sought participation by private Japanese, American and European firms. Washington and Brussels, worried that the plan was nothing more than a ruse to erase the American and the European leads in some software and engineering areas and to establish Japanese dominance in manufacturing technologies, insisted that the project be handled at the government-to-government level. After several rounds of talks, the three sides have yet to move beyond basic subjects. It does appear, however, that IMS eventually will go forward in a form far different from what Tokyo originally envisioned.

Tokyo's campaign to open existing or planned government-industry research consortia to foreign firms continues to make slow progress. To encourage foreign participation Tokyo has liberalized the rules for joint research projects, paying particular attention to an equitable sharing of resultant intellectual property rights. During FY 1990 and FY 1991 at least seven foreign firms (often via their Japanese subsidiaries) joined or will join new public-private research projects, a cooperative approach credited by some as key to Japan's rapid development of technology. International Business Machines Corp., American Telephone & Telegraph Co. and Siemens AG of Germany will join MITI's program to develop new information processing technology, the so-called Sixth Generation computer project. SRI International of California will participate in two government projects, one to develop the next generation of computer languages and the other involving advanced chemical processing technology. Dow Corning Corp. will participate in a study of silicon-based polymers from FY 1991 through FY 2001. MITI reports that about 10 percent of the companies interested in its upcoming micro-machines project are foreign affiliates.

- Private efforts - As mentioned above, private Japanese firms are under increasing pressure to internationalize their R&D. They have responded in several ways. Japanese companies gradually are opening their research facilities at home to foreigners. Hitachi, Ltd. (35 positions), NEC Corp. (26 openings) and Nippon Telegraph and Telephone Corp. (50 fellowships) include foreign scientists on the staff of some of their top research laboratories. NEC, in particular, has taken the symbolically important step of naming a foreigner to head one of its research labs. Foreign critics point out, however, that such programs remain tiny in comparison to Japanese access to foreign research facilities.

The importance of tapping Japan's R&D resources is becoming clear to an increasing number of foreign firms. Besides participating in government research projects, foreign companies are examining whether opening their own laboratories in Japan is worthwhile. According to a study done for the National Science Foundation, more than 70 American firms have wholly owned or joint venture research facilities in Japan.[1] The NSF study, based on a 1990 survey of about half these firms, destroys some myths about foreign research in Japan and indicates that it is rapidly evolving.

The study showed that less than 30 percent of the foreign research facilities surveyed were established within the past five years; the majority have been in Japan for more than 10 years. Companies such as IBM, Xerox Corp., Eastman Kodak Co., Mobil Oil Corp. and Dow Corning Corp. have had a research presence in Japan for more than 25 years. Many of the newcomers are in the computer and electronics fields, including Intel Corp., Applied Materials Inc., Apple Computer Inc. and Oracle Corp.; their goal is to seek closer ties to Japanese customers. Like their Japanese counterparts, American R&D subsidiaries were established in Japan to improve the bottom line. Nearly all the facilities were engaged in product development; more than half were engaged in both applied research and process development; less than a quarter performed some basic research. (Only one was engaged entirely in basic research.)

Most interesting were the goals that U.S. firms listed for establishing a Japanese R&D facility. Chief of the "most important" reasons was "to develop products tailored to the Japanese market." This was followed by "the need to meet Japanese government standards." Third among the main reasons was "the desire to gain entry into the Japanese R&D establishment." As for the "least important" reasons, the one most often cited was "qualifying for Japanese government R&D loans or programs." This was followed by "establishing a Far East research base" and "exploiting skills of Japanese scientists and engineers." There was a sharp division on the goal of "increasing effectiveness of absorbing technology developed in Japan," with about 30 percent calling this "very important" but nearly 60 percent saying it was "least important." When foreign firms did try to access Japan's R&D resources, the response was overwhelmingly positive; more than 90 percent said their Japan-based R&D subsidiary gave them better access to Japanese industrial research. The subsidiaries, they noted, also were allowed to join local research associations. Such responses lend weight to Japanese arguments that the technology flow imbalance is due to a lack of foreign interest in Japanese technology and not a lack of access.

Overall, respondents were very satisfied, saying that the Japanese R&D subsidiary had met its objectives. The surveyed firms felt the cost-effectiveness of industrial research in Japan was superior to that in the United States, in part because of the dedication to R&D of both Japanese researchers and managers. Although the costs of establishing a research operation in Japan can be high (many foreign firms report great difficulty hiring all types of employees), investment does pay off. Tokyo has announced several steps aimed at reducing the cost barrier, including low-interest loans from the Japan Development Bank and some breaks on real estate and local taxes (see JEI Report No. 35A, September 20, 1991). The fact that Japan is at the cutting edge of technology in many areas will continue to attract foreign firms to Japan, possibly improving the flow of Japanese technology overseas.

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[1] National Science Foundation, Survey of Direct U.S. Private Capital Investment in Research and Development Facilities in Japan, NSF 91-312 (Washington, DC, 1991).

Conclusion

Japan's well-nourished, healthy and vigorous R&D will ensure that Japanese industry will remain internationally competitive well into the next century. Government and business leaders understand, however, that the global economic and political environment is undergoing some fundamental changes, which entail shifts in Japanese policies as well. As part of its bid to play a larger international role, Tokyo has pledged that Japan will become a net contributor to the world's storehouse of basic and applied knowledge. The small steps in this direction reflected by government and private research budgets show that the shift will take much time, but that movement is occurring.

Equally important to the fulfillment of Tokyo's pledge is the attitude of foreigners to Japanese R&D. Tokyo's multinational R&D initiatives have been met with skepticism and suspicion (often with some justification). Similarly, Tokyo's response to some multilateral initiatives from overseas also has been lackluster. Because private companies play a predominant role in Japanese R&D, the best opportunity for increasing the flow of Japanese technology abroad may be an expanded private foreign research presence in Japan. Rather than bemoaning the competitive threat posed by Japanese R&D, foreign firms might fare better if they tried to turn it to their advantage by becoming insiders in Japan's R&D community.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JEI REPORT

A Two-Part Report: A and B

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September 27, 1991

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Japan's Economy Shows Sluggish Growth

Three months ago economists said the news concerning Japan's rapid rate of economic expansion was too good to last. Even these economists, however, were a little surprised after the Economic Planning Agency released in late September the April to June 1991 figures that showed Japan's gross national product grew a real, seasonally adjusted 0.5 percent from the quarter before; these data translated to 2 percent growth on an annual basis. In the January to March period, by contrast, GNP had jumped an annualized 11 percent (see Table). The second quarter figures represented the slowest quarterly rate of growth in exactly two years.

Government officials, and some independent experts, downplayed the importance of the second quarter data. After the strong first period a significant slowdown was inevitable, they suggested. In fact, to the extent that EPA's critics were correct in pointing out technical deficiencies in the first

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1989	FY 1990	July-September 1990	October-December 1990	January-March 1991	April-June 1991
Gross National Product	Y388,200.2 (4.8%)	Y410,487.3 (5.7%)	Y407,432.8 (4.6%)	Y410,021.2 (2.6%)	Y420,903.7 (11.0%)	Y423,028.3 (2.0%)
Personal Consumption Spending	225,493.4 (4.1%)	233,590.7 (3.6%)	233,453.1 (0.6%)	232,841.7 (-1.0%)	235,147.4 (4.0%)	239,293.0 (7.2%)
Private Residential Construction	21,712.5 (0.7%)	23,916.3 (10.1%)	24,616.2 (25.9%)	24,218.7 (-6.3%)	23,525.9 (-11.0%)	21,943.3 (-24.3%)
Private Fixed Nonresidential Investment	78,954.0 (14.1%)	89,540.0 (13.4%)	87,867.2 (9.4%)	90,949.6 (14.8%)	92,848.6 (8.6%)	92,805.9 (-0.2%)
Change in Business Inventories	3,616.1 (*)	3,164.1 (*)	3,512.8 (*)	2,710.5 (*)	3,129.9 (*)	3,470.0 (*)
Government Current Expenditures	33,651.5 (1.9%)	34,135.4 (1.4%)	33,945.9 (0.5%)	34,185.3 (2.9%)	34,495.3 (3.7%)	35,004.9 (6.0%)
Government Fixed Investment	25,270.4 (1.0%)	26,043.0 (3.1%)	26,018.8 (0.9%)	26,046.1 (0.4%)	26,144.0 (1.5%)	27,030.1 (14.3%)
Change in Government Inventories	-55.5 (*)	126.7 (*)	603.0 (*)	-724.7 (*)	169.4 (*)	-19.2 (*)
Net External Sector	-442.1 (*)	-28.9 (*)	-2,584.2 (*)	-206.0 (*)	5,443.2 (*)	3,500.3 (*)
Exports of Goods and Services and Factor Income Received	68,574.3 (15.6%)	73,948.7 (7.8%)	70,837.4 (-16.3%)	73,259.1 (14.4%)	77,580.1 (25.8%)	75,441.1 (-10.6%)
Imports of Goods and Services and Factor Income Paid	69,016.4 (20.2%)	73,977.6 (7.2%)	73,421.6 (-17.7%)	73,465.1 (0.2%)	72,136.9 (-7.0%)	71,940.8 (-1.1%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

quarter results (see JEI Report No. 24B, June 28, 1991), the second quarter numbers could be read as a corrected version of where the economy stands; taking the first two quarters of 1991 together the economy would appear to be very healthy. By the criteria applied to most industrial economies, in fact, even 2 percent annual growth in the second period does not look bad at all.

EPA's relatively upbeat assessment of the data appears well-founded with respect to the statistics relating to the foreign sector. In contrast to the first quarter, net exports were a drag on the economy, shaving 0.5 percentage point off the quarterly growth rate. To a substantial extent this result reflected the return of Japanese tourists to overseas vacation spots following a sharp drop in the first quarter when hostilities in the Middle East discouraged all trips abroad. Overseas tourism is not likely to surge to the same extent in future periods.

Except for government officials in their public pronouncements, however, most analysts viewed the latest figures with considerable concern, in part because they believe that the economy is in worse shape than the data showed. The most striking single figure in the latest statistics was private plant and equipment spending, which slipped an annualized 0.2 percent from the previous quarter, the first quarterly decline in two years. EPA officials downplayed the significance of the drop, arguing that large corporations increased their spending. Private-sector economists focused on the other side of the coin: a sharp decline in spending by small companies. One could argue that small firms are more sensitive to capital markets and experienced the bite of higher interest rates sooner than large companies; absent much lower interest rates, big firms could be expected to feel the pinch soon as well. Other data also suggest that the worst may be yet to come. Orders for equipment (excepting ships and orders by electric utility companies), a statistic considered a leading indicator of corporate investment spending, were down sharply in the quarter. In another sign that continued high interest rates orchestrated by the Bank of Japan are having an effect, real investment in housing dropped sharply again, putting it at the lowest level since the October-December 1989 period.

The sharp rise in inventory levels also was telling, most probably reflecting unanticipated weakness in demand. The immediate effect of the upward movement for the second straight quarter was to push quarterly growth 0.1 percentage point higher. Firms eventually could trim their inventories, however, by reducing production below levels they otherwise would reach, and this would have probable negative effects on related sectors of the economy.

In what appears to be part of rising criticism of EPA's data collection effort, private economists even questioned the one apparent bright spot in the recent figures. Consumer spending was up 7.2 percent on an annual basis from the quarter before and boosted the overall growth rate by a full percentage point. One critic suggested, however, that much of the apparent rise came from automotive sales, which other data suggest are not healthy at all. Furthermore, more recent data on department store sales point to a marked slowdown in consumer spending activity, implying that, even if the consumer spending figures for the April-June period are accurate, the current quarter is not likely to look nearly as strong.

In short, private-sector economists tend to believe that the second quarter figures are a forerunner of even worse numbers for the current quarter, when GNP may register negative growth. Even though recent forecasts, such as one from the Industrial Bank of Japan, Ltd., call for GNP to grow by 3.5 percent in the April 1, 1991 to March 31, 1992 fiscal year, these estimates reflect an important arithmetic reality. Given the spillover effect of rapid growth toward the end of the previous fiscal year, the economy would grow by 3.1 percent for the entire fiscal year even if the three remaining quarters of fiscal 1991 were to show no growth at all. Should the 3.1 percent growth figure, or something close to it, materialize by next spring, it would be evidence that Japan had experienced a chilly economic season or two.

Douglas Ostrom

Japanese Government Introduces United Nations Peacekeeping Bill

Reflecting growing public support for a more engaged foreign policy, the Japanese government introduced legislation September 19 that would allow lightly armed military personnel to participate in United Nations-sponsored peacekeeping operations. If enacted, this legislation would set the stage for the deployment overseas of as many as 2,000 Self-Defense Forces members -- the first such dispatch in Japan's postwar history. The government of Prime Minister Toshiki Kaifu also sent to the Diet a separate, related bill that would allow SDF personnel to engage in overseas disaster relief missions. Both measures, in effect, are belated responses to international criticism that Japan did not support in a timely or an appropriate manner multilateral coalition efforts to expel the forces of Iraqi President Saddam Hussein from Kuwait (see JEI Report No. 6A, February 15, 1991). Tokyo hopes to demonstrate to its allies through this legislation that Japan is willing as a global economic power to assume greater responsibility for maintaining world peace.

In a press conference following the cabinet's September 18 approval of the legislation chief cabinet secretary Misoji Sakamoto sought to preempt criticism that the bills might violate provisions of Japan's constitution that for more than 40 years have been interpreted as barring the dispatch overseas of SDF equipment and personnel. Use of weapons would be "minimal" and SDF personnel would be withdrawn from the peacekeeping operation if a ceasefire broke down, Mr. Sakamoto reportedly stated.

Nearly one year ago Mr. Kaifu was forced to withdraw a similar proposal because of stiff resistance from the opposition parties, his own Liberal Democratic Party and certain Southeast Asian countries (see JEI Report No. 44B, November 16, 1990). But a shift in domestic and international opinion has accompanied the winding down of the Cold War, the victory of the coalition forces in the Persian Gulf War and, the related, renewed importance of the United Nations as a peacekeeping forum, the chief cabinet secretary was quoted as saying. Indeed, Japanese opinion polls since the beginning of the year have shown a steady increase in support for SDF involvement in U.N.-sponsored peacekeeping activities (see JEI Report No. 31A, August 16, 1991). According to some analysts, the Japanese government's decision to send minesweepers to the Persian Gulf last April to assist postwar cleanup of the mine-ridden area most likely would not have been possible without these changes in domestic mood and global political conditions (see JEI Report No. 17B, May 3, 1991).

Also, unlike last year, the LDP-led government worked closely with the two centrist opposition parties, Komeito and the Democratic Socialist Party, in

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SAVINGS, INVESTMENT AND THE GROWTH OF THE JAPANESE ECONOMY

Summary

Japan's high level of household savings compared to other countries, particularly the United States, is well-known. Yet, even though some experts are tempted to place savings high on the list of factors that explain Japan's postwar economic growth, the connection is not as clear as it superficially might appear. First, household savings rates, once measured in a comparable manner, do not differ as much between the United States and Japan as unadjusted figures suggest. Second, household savings are only one source of savings among several; the remaining sources explain an increasing amount of the savings rate gap between the United States and Japan. Third, savings rates are not necessarily linked to investment rates, which, in turn, have a changing relationship to the growth of the capital stock. Finally, changes in the capital stock do not correspond to economic growth in the same way as in past years. Although Japan's experience suggests the United States probably would benefit from measures to boost the rate of household savings, such benefits would be far less clear-cut than a quick comparison of personal savings rates would suggest.

Japan's Savings Rate in International Perspective

Critics of American economic policy often point to the apparently dismal U.S. personal savings rate over the past couple of decades as evidence that policies should be changed dramatically, perhaps by liberalizing individual retirement accounts or creating "family saving" incentives. Were Congress to encourage individual savings through enhanced IRAs or other means, the most immediate result of such plans, if successful, would be to increase the household savings rate. The Department of Commerce put that figure at a seasonally adjusted 4.2 percent in the second quarter of 1991.

Table 1 shows how the U.S. figure compares with those of three other members of the Group of Seven industrial nations. (France, Italy and the United Kingdom are excluded because their methods of data collection differ significantly.) Among these countries America consistently has had the lowest rate, Japan the highest. (Of the 15 Organization for Economic Cooperation and Development nations using roughly comparable data collection methods, four -- Finland, Norway, the Netherlands and Sweden -- had lower rates than the United States in 1989; one -- Belgium -- had a rate clearly higher than Japan's.) While both American and Japanese rates have declined in recent years, even the lowest Japanese rate still is higher than the U.S. rate at its zenith.

Table 1: Household Savings Rates in Selected Countries, 1975-90

	United States	Japan	West Germany	Canada
1975	9.4%	22.8%	15.4%	12.7%
1980	7.3	17.9	13.1	13.6
1981	7.7	18.3	13.9	15.4
1982	7.0	16.5	12.9	18.2
1983	5.5	16.3	11.3	14.8
1984	6.3	15.8	11.6	15.0
1985	4.5	15.6	11.5	13.3
1986	4.3	16.1	12.4	10.7
1987	3.0	14.7	12.7	9.4
1988	4.3	14.3	12.7	10.0
1989	4.7	14.2	12.6	11.0
1990 (est.)	4.6	14.3	13.4	10.9

Source: Organization for Economic Cooperation and Development

Many experts have noted the different external factors that motivate Japanese households to save more, particularly reasons that have little to do with a desire for thrift per se. For example, bonus payments figure prominently in the annual compensation of Japanese employees; some evidence suggests that such lump-sum distributions are more likely to be saved than other forms of income, thereby boosting the Japanese rate vis-a-vis the American one, other factors equal. (Income tax refunds, more common in the United States, are a counterexample.)

For every critic who uses the figures in Table 1 to find economic -- or moral shortcomings -- in the United States, there is at least one critic who faults the data. A well-known analyst even has argued that, once appropriate adjustments are made, the two countries save about the same percentage of their

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disposable income.[1] Few experts believe, however, that proper measurement techniques would close the gap between the American and the Japanese savings rates. Yet, most of them would agree that the difference would not be as great as suggested in Table 1. Their comments distinguish between problems arising in the proper measurement of personal savings and whether individual savings are an adequate barometer of overall savings.[2]

First, these experts argue that the United States and Japan, while employing methods more similar than many other pairs of countries, differ substantially in how they calculate personal savings rates. Conceptually, personal saving is income that is not consumed. Both Japan and the United States recognize that long-lived assets wear out and, thus, in aging they impose a cost on their owners, albeit not an out-of-pocket expenditure; therefore, depreciation should be recognized as an expense, reducing savings. However, the United States values this expense at replacement cost, Japan at historical cost. In periods of inflation replacement cost exceeds historical cost. Since price increases have been the norm for both countries, Japan's depreciation of household expenses has been undervalued by U.S. standards, leaving savings overreported. This discrepancy could add 2 to 3 percentage points to the U.S. data in Table 1 or reduce the Japanese figures by an equal amount.[3] Other differences in measurement have less influence.

Second, many experts note that Japan and the United States both make what could be regarded as mistakes in the calculation of the personal savings rate by misjudging what is consumed or, in other words, what is saved. While, as noted above, long-lived assets create problems related to the determination of historical versus replacement cost, they also raise the question of deciding what is long-lasting and what is not. Expenditures for many durable goods are counted inappropriately as consumer spending. For example, money spent for furniture should not count as consumer spending in the year in which the furniture is purchased since it is "consumed" over a period of years, not during the quarter or the year to which the data refer; yet in savings statistics furniture is treated the same way as movie tickets (which typically are consumed within hours of being purchased). The effect of counting such durable goods expenditures as consumer spending is greater in the United States than in Japan, suggesting that a proper measure would boost the U.S. rate by as much as 2 to 3 percentage points vis-a-vis Japan.[4]

The combined effect of adjusting for methodological differences and questionable methodology is to reduce the gap between the U.S.-Japan savings rates shown in Table 1 by about half. Nonetheless, a gap remains. With the proposed adjustments the Japanese figure would fall to perhaps 11 or 12 percent, still comfortably above the similarly adjusted U.S. rate, which would rise only a couple of points at most above its 1989 level of 4.7 percent.

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[1] Kenichi Ohmae, "Americans and Japanese Save About the Same," Wall Street Journal, June 14, 1988.

[2] For a summary of many of the arguments concerning household savings in Japan and references to the original articles, see Charles Yuji Horioka, "Why is Japan's Household Savings Rate So High? A Literature Survey," Journal of the Japanese and International Economies, 1990, No. 4, pp. 51-54.

[3] Ibid., p. 53.

[4] Ibid., p. 53.

Most experts recognize that the figures on personal savings, no matter how well-calculated, are but one part of the savings equation. Economists typically divide the economy into three parts or more -- households, business and government, for example -- each of which may be a source of or a net user of savings.

For all their complexity household or personal savings are easier to measure than the others. Because individual savings also often contribute the largest amount to the country's savings pool, many analysts use personal savings as a proxy for overall savings. As Table 2 shows, however, household savings in Japan no longer rank as the overwhelming source of savings. Still, personal savings are far more stable in both countries than government or business savings. A discussion of changes in overall savings rates, thus, almost necessarily requires a look at the remaining sources.

Table 2: Distribution of Net Savings by Sector in Japan, 1976-89

	Households	Financial Firms	Nonfinancial Firms	Government	Private Nonprofit Organizations
1976	85.5%	3.1%	0.6%	9.8%	0.9%
1977	80.9	1.6	5.0	11.6	0.9
1978	74.7	1.7	14.8	7.1	1.8
1979	67.5	3.0	15.4	12.6	1.5
1980	69.1	3.3	12.2	14.1	1.2
1981	70.8	0.2	11.0	16.7	1.3
1982	68.3	1.5	12.4	16.3	1.5
1983	70.3	0.8	13.6	14.3	1.1
1984	64.0	-0.2	16.7	18.7	0.8
1985	59.3	-0.8	17.4	23.5	0.6
1986	60.8	-4.2	20.2	22.5	0.7
1987	53.7	-6.2	21.2	30.6	0.6
1988	48.3	-4.8	21.4	34.6	0.5
1989	48.0	-6.1	17.8	39.4	0.9

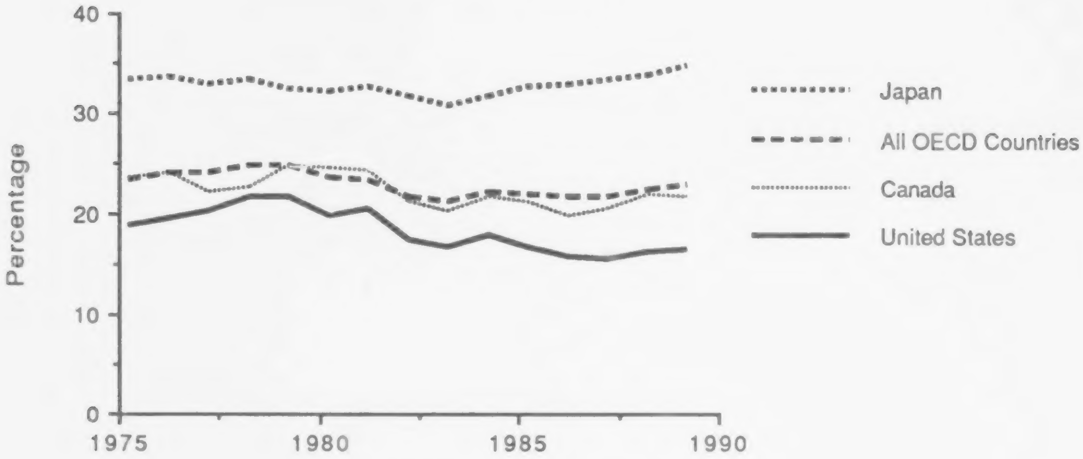
Note: For each sector savings are net of depreciation but not net of investment.

Source: Calculated from data in Economic Planning Agency, Annual Report On National Accounts (Tokyo: Okura-sho Insatsu-kyoku, 1991).

Figure 1 shows how overall savings rates differ among the United States, Japan, Canada and the 24 member countries of the OECD taken as a whole. The overall U.S. savings rate has experienced several sharp declines, while Japan's rate has been roughly stable since 1975, climbing in the late 1980s. (Canada's rate roughly has paralleled that of the United States, although the figure itself has remained higher.) The relatively poor U.S. performance largely is a

Figure 1: Overall National Savings Rate

(percentage of GNP or GDP)



Source: Organization for Economic Cooperation and Development

consequence of soaring federal budget deficits, which have resulted in substantial government dissaving. In contrast, as Table 2 shows, government savings in Japan represent an increasing share of total net savings. There, a substantial portion of government savings finances government investment.

As in measurements for personal savings, methodological choices required to generate overall savings rates are open to dispute. Some experts have argued that the overall U.S. savings rate approximates that for Japan once a consistent and correct approach is taken toward measuring Japanese and American savings. As with household savings, however, the differences only narrow; they do not disappear.[5]

Some of the apparent differences in American and Japanese rates arise from the treatment of government spending and saving. Government purchases, like consumer expenditures, are partly for durable goods, such as tanks. Like their equivalents in the private sector, these durable purchases arguably should not be counted as consumption since they can be expected to have several years of useful life. If they are excluded, government savings rates are higher. Yet some government investment, such as that for tanks, clearly has a different impact on future levels of productivity than spending on factories or education, suggesting that the case for its inclusion is less than clear-cut. Figure 1 is based on OECD measurements, which count military expenditures but do not include as consumption a broad array of government spending on long-lived assets, such as bridges. As such, this gauge represents a compromise between very inclusive and very exclusive views of government expenditures on durables.

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[5] Fumio Hayashi, "Is Japan's Savings Rate High?" Quarterly Review (Federal Reserve Bank of Minneapolis), Spring 1989, pp. 3-9.

The Congressional Budget Office has argued that only a very inclusive view of government savings, one that considers the impact of military investment, would alter significantly the level of government savings. That outcome would result in part because depreciation charges would reduce net government savings. CBO also noted that none of the alternative measurements it evaluated would affect the trend of U.S. government savings, which generally have moved downward since about 1970.[6] In other words, reclassification of some government expenditures from current spending to investment would not alter significantly the downward trend of U.S. aggregate savings as shown in Figure 1.

Relationship of Savings and Investment

In everyday use the words "savings" and "investment" are used almost interchangeably, as in the assertion "I got a good return on my savings (investment) last year." Economists, too, find the concepts closely related but employ a special meaning for each word. The production of goods and services in every economy is part of a process in which workers and others get income that in total equals what they pay in aggregate to purchase goods and services. Savings refer to decisions by buyers not to spend their entire incomes to consume the goods or the services that the economy and, ultimately, they themselves have produced. To an economist investment relates to the fact that not all the goods and the services produced domestically or made available from foreign sources are consumed in the period in question. As such, it has relatively little to do with the concept as understood on Wall Street.

In some cases the decision to invest and to save are the same side of a coin. For example, the profits that a corporation decides not to disburse to shareholders represent corporate savings. If these undistributed profits are used to buy long-lived equipment, the decision represents investment since some of the output of the economy (the equipment) is not consumed in the current period. More often, however, the investment and the savings decisions are made by different economic entities. In the above example, if the firm used borrowed money rather than retained earnings, it still would be making an investment decision, but those who add enough to their checking or savings accounts to finance the bank loan would make the savings decision. In a closed economy or for the world as a whole, savings and investment necessarily are equal, even if the decisions to invest and to save may be made by different people. Any diversion of current production from current consumption -- in other words, investment -- must be matched by decisions somewhere to defer using a similar portion of income in the current period -- that is, savings.

Financial institutions and capital markets enable savings and investment decisions to be made increasingly independently. This suggests that Japan's high personal savings rate does not necessarily imply a high individual investment rate; the savings can go into the bank rather than into personal investments like a new house. Furthermore, with the advent of global capital markets, savers in one country can finance investments in another nation. Hence, one might expect that national savings as shown in Figure 1 have relatively little to do with national investment if funds flow freely across national boundaries. Conversely, if funds are prevented from free movement, then savings and investment are linked closely.

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[6] For details, see Congress of the United States, Congressional Budget Office, The Federal Deficit: Does It Measure the Government's Effect on National Saving? (Washington: Congressional Budget Office, 1990), pp. 21-25.

In the case of Japan the question of the linkage between savings and investment is of obvious importance. High investment is an engine of long-term economic growth. New plant and equipment as well as investments in research and development or education are factors making tomorrow's economy more productive. Are a high rate of investment and subsequent rapid economic growth inevitable given Japan's savings rate? Surprisingly, perhaps, expert opinion is mixed on this question.

One way to assess the situation is to look at how interest rates differ by country. If they tend to move together and are more or less equal after taking into account exchange rate expectations, risk and a few other factors, then one can assume that temporarily high rates in one country attract funds from nations with relatively low rates. If Japan tended to have relatively low rates because of a large supply of savings, for example, those funds would be attracted overseas, provided that supply and demand conditions there created high returns on savings. Given the equality-based view of interest rates, supply and demand would push up rates in the country from which the funds came and lower them in the country into which they flowed in a continual process until rates were roughly equal and had moved the same amount in each country. Experts who have studied worldwide interest rates have found some evidence that interest rates move in the way predicted. The natural inference to draw is that high domestic savings do not necessarily imply high national investment.

Unfortunately for this theory. studies of the direct connection between savings and investment often have reached an opposite conclusion. On balance, nations with high savings apparently do have high levels of investment. Tamim Bayoumi of the International Monetary Fund summarized and confirmed these findings and offered as an explanation the notion that government policies either could restrict the flow of savings across national boundaries directly or result in fiscal decisions that could create a connection between overall savings and overall investment.[7] Regarding fiscal policies, Mr. Bayoumi presumably meant that high rates of business and household savings encourage governments to increase public spending, a portion of which becomes public investment. In this way overall savings and investment are linked. In contrast, private savings and private investment barely are related, according to his research. Hence, private savings do not lead inevitably to higher private investment.

The situation in Japan is more complex. According to Mr. Bayoumi, private investment and private savings there were each higher on average between 1965 and 1986 than in any of the other nine industrial nations (including the United States) that he used for comparison. This result would seem to suggest that private investment in Japan is high because of high private savings, after all. (Mr. Bayoumi himself does not draw this inference. however.)

[7] Tamim Bayoumi, "Saving-Investment Correlations," IMF Staff Papers, June 1990, pp. 360-387.

Other evidence, however, casts doubt on this apparent result. To compare Japan and other nations, Mr. Bayoumi used average values that included observations from the 1960s when Japanese capital markets arguably were much more closed than they are today. However, his own time-series data for Japan showed that the relationship between private savings and investment began to weaken in the mid-1970s while that between total savings and investment began to erode in the 1980s. The data in Table 3 hint at the same breakdown in this relationship. To the extent that savings exceed investment, funds flow abroad. Between 1980 and 1986 the difference between savings and investment widened in Japan, with lending to the rest of the world increasing.

Table 3: Japanese Savings and Investment Data, 1976-89

	Net Savings/ GNP	Net Investment/ GNP	Adjustments*/ GNP	Net Lending to Rest of World/ GNP
1976	20.2%	19.4%	-0.1%	0.6%
1977	19.6	18.5	0.4	1.5
1978	20.0	18.7	0.3	1.7
1979	19.0	20.0	0.1	-0.9
1980	18.3	19.5	0.1	-1.0
1981	18.3	18.0	0.1	0.4
1982	17.1	16.5	0.0	0.7
1983	16.2	14.4	0.0	1.8
1984	17.2	14.4	0.0	2.8
1985	18.1	14.5	0.0	3.6
1986	18.1	13.9	0.0	4.2
1987	18.5	14.5	-0.4	3.6
1988	19.7	16.4	-0.5	2.7
1989	19.5	17.1	-0.5	2.0

*Statistical discrepancy and capital transfers.

Note: Net lending to rest of world -- the result of net savings minus net investment plus adjustments -- is equivalent to the external surplus.

Source: Calculated from data in Economic Planning Agency, Annual Report On National Accounts (Tokyo: Okura-sho Insatsu-kyoku, 1991).

Research based on rates of return in Japanese financial markets also supports the conclusion of increased capital mobility.[8] Studies of the relationship between Japanese and foreign markets tend to show that after 1980 (the year in which the Foreign Exchange and Foreign Trade Law was overhauled) interest rates in Japan and the United States -- or dollar-denominated securities in the Euromarket -- converged once proper adjustments are made for exchange rate movements.

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[8] See, for example, Mustafa N. Gultekin, N. Bulent Gultekin and Alessandro Penati, "Capital Controls and International Capital Market Segmentation: The Evidence from the Japanese and American Stock Markets," Journal of Finance, September 1989, pp. 849-869, and Robert Alan Feldman, Japanese Financial Markets (Cambridge, Massachuesetts: MIT Press, 1986), pp. 181-185.

In short, at least for Japan, the apparent contradiction between studies of savings-investment patterns and those of international interest rate differentials does not exist. Both types of statistics suggest that Japanese financial markets have been integrated into the world economy to a significant degree since 1980. The implied result is that Japanese savers increasingly seek the highest return anywhere in the world. An extreme view of this decoupling argument would suggest that Japanese savings and investment are both high only by coincidence. While few experts would be willing to go that far, most would agree that the savings-investment linkage weakened significantly, if did not disappear, in the 1980s. This analysis implies that high savings are less tightly linked now than in the past to high economic growth since the path to rapid growth leads through investment, which is becoming less directly tied to domestic savings.

Relationship of Investment to the Capital Stock

Even if one assumes that high savings lead to high investment in Japan, so what? Only if the investment generates a larger or more productive stock of capital will the economy grow as a result.

Investment and its relationship to increases in the capital stock depend in part on the rate of depreciation. To the extent that capital wears out or becomes obsolete, any given level of investment increases the capital stock less than it would otherwise. The Council of Economic Advisers has pointed out that equipment -- which wears out relatively rapidly compared to structures and other fixed assets -- has risen in recent years in the United States as a share of the capital stock. For this reason, even though gross investment actually rose in the 1980s relative to gross national product, net investment fell relative to net national product (GNP less depreciation).[9]

A related phenomenon has occurred in Japan. Equipment's share of non-residential fixed investment increased steadily throughout the 1980s; in the most recent period for which comparable data are available (1983 to 1989), the ratio rose from 17.4 percent to 22.2 percent. The large stock of computers and other fast-depreciating equipment has trimmed significantly the increase in net investment spending despite a rapid expansion of gross investment expenditures. (See Figure 2 where gross investment equals the sum of net investment and depreciation charges.) But unlike the U.S. case, where the share of net investment spending in the economy has eroded, the share of net investment expenditures in Japan increased from 16.7 percent of estimated NNP in 1984 to 19.9 percent in 1989. Partly as a result, Japan's net capital stock has grown at a relatively rapid pace in recent years (see Figure 3).

Some evidence suggests, however, that increases in the capital stock deliver less in the form of increased output than they did a generation ago (or

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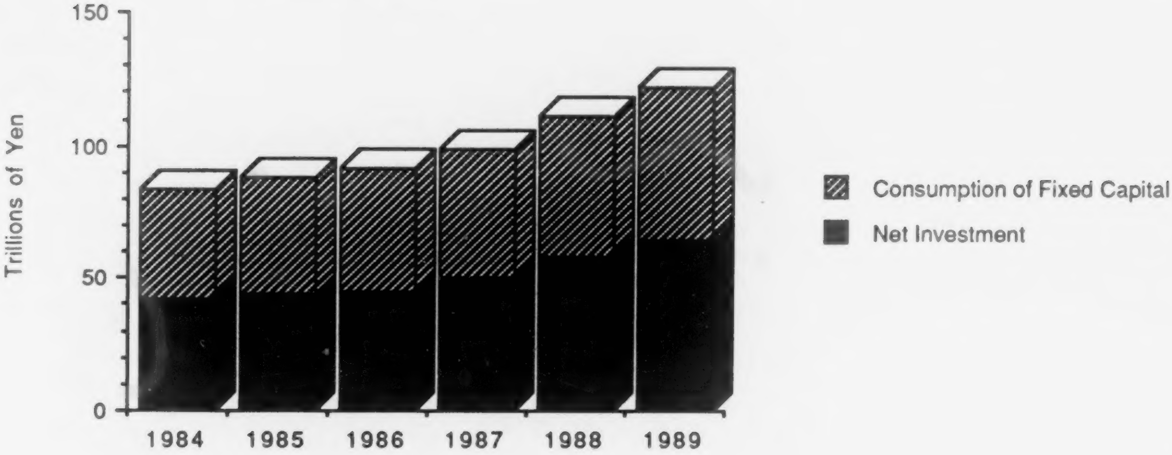
[9] Economic Report of the President (Washington, D.C.: Government Printing Office, 1990), p. 119.

Figure 2: Domestic Fixed Capital Formation in Japan

(in current prices)



Source: Economic Planning Agency

perhaps even last year). Kazuo Sato, a professor at Rutgers University, calculated capital-output ratios in Japan's primary and secondary industries in a 1987 report; his figures showed that the two series climbed sharply between 1970 and 1975 as firms, faced with tighter labor markets, began substituting capital for labor. Through 1983, the most recent year for which Mr. Sato had data, the ratios remained on the plateaus reached in 1975.[10] This result suggests that a given level of Japanese output required more capital -- and, ultimately, more investment and savings -- than in the past.

Using a slightly different yardstick, Nomura Research Institute recently reported that Japan's ratio of capital to output rose virtually every year between 1966 and 1990, more than doubling over the period.[11] Assuming that this long-run trend continues, the data imply that the high level of capital spending by Japanese firms in recent years will generate a smaller growth in potential output than that produced by past increases in the capital stock. As will be discussed below, this trend has significant implications for the pattern of future Japanese economic growth.

The Bottom Line

The connection between capital and output completes the description of the linkage of personal savings to economic growth. Several conclusions emerge

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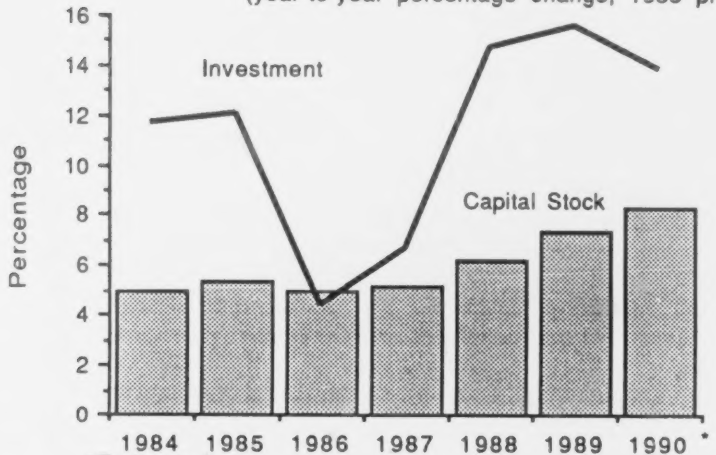
[10] Kazuo Sato, "Saving and Investment" in Kozo Yamamura and Yasukichi Yasuba (eds.), The Political Economy of Japan, Volume 1. The Domestic Transformation (Stanford, California: Stanford University Press, 1987), pp. 165-168.

[11] NRI Quarterly Economic Review, August 1991, p. 6.

Figure 3: Real Net Private Nonresidential Fixed Capital Stock and Investment in Japan

(year-to-year percentage change, 1985 prices)



*Estimated.

Note: Data refer to capital stock in financial, nonfinancial and nonprofit institutions plus gross private plant and equipment investment.

Source: Economic Planning Agency

from this discussion. First, savings come from many sources -- both domestic and foreign. One reason the United States has a low overall savings rate vis-a-vis Japan is because the rate of government savings is low, a result of big federal budget deficits since the start of the 1980s. This finding suggests that, insofar as domestic savings affect growth, American policymakers who attempt to draw lessons from the Japanese experience need to cast their net widely, looking not just at household patterns of thrift but at business decisions and government fiscal policy.

Second, the linkages between savings and investment, between investment and growth in the capital stock and between the capital stock and output all have been changing in Japan since the early 1980s, if not before. In every case the effect has been to weaken the linkage. No evidence points toward these trends slowing, let alone reversing. This argument suggests that, other factors equal, the Japanese economy increasingly will be swimming upstream in its efforts to maintain growth. Of course, savings still remain high in Japan, and the relationships that lead to growth, while weaker than in the past, have not disappeared. In addition, savings are hardly the only mechanism for maintaining a solid economic performance; in many other factors, such as education and training, Japan excels. In short, while Japan will have to buck the current to maintain solid growth rates, it is a strong swimmer.

Outlook for Savings and Investment

Through the end of 1991 and next year Japanese policymakers will have to guide the economy through some particularly difficult stretches, many of which involve changes in savings and investment behavior. The most immediate problem is the overhang from the investment surge of the late 1980s. Having increased to nearly 20 percent of GNP, plant and equipment spending could play a destabilizing role in the economy as a whole. As the economy appeared to be entering a slow growth period this past spring, concerns centered on business investment, which actually declined in the April-June 1991 quarter from the previous three-month period (see JEI Report No. 36B, September 27, 1991). Should plant and equipment spending remain weak, the Bank of Japan is likely to relax further monetary policy in an effort to bring interest rates to a level that makes investment attractive.

Absent a substantial move toward a looser monetary policy, the prospects for Japanese plant and equipment spending are uncertain. The high levels of outlays in the late 1980s were financed in part by equity-linked bonds. According to data collected by Salomon Brothers Inc., in the peak year of FY 1989 roughly one-third of the external funds obtained by Japanese nonfinancial corporations were generated this way. Firms were able to raise money at low rates because potential investors were attracted by the prospect that equity purchase rights would be valuable if the stock market continued the rapid advance it then was experiencing. After the stock market's 1990 decline and continued weakness in 1991, this source of finance has all but disappeared.

In addition, Y14 trillion ($103.7 billion at Y135=$1.00) of equity-linked bonds will mature during the FY 1992-FY 1993 period, an amount substantially higher than the Y8.7 trillion yen ($64.4 billion) raised on capital markets in FY 1990. For issuing firms, which had hoped to redeem their outstanding bonds with the proceeds from sales of stock, refinancing is an unexpected burden regardless of interest rates. As it is, firms will have to refinance at much higher rates unless the stock market stages a strong recovery that restores the attractiveness of the bonds' equity component.

Nor are other sources of funds attractive. Bank loans are both less available and more expensive as banks struggle with their own problems. Furthermore, since corporate profits have declined this year compared to last year and are unlikely to recover significantly in the near term, the prospects for increased use of retained earnings to finance investment appear dim.

Faced with unattractive alternatives, firms will have to consider reducing their holdings of liquid assets, like cash or cash equivalents. By mid-1991 Japanese firms were running down these assets fairly rapidly; ultimately little could be left in the cookie jar for future expansion. By a Salomon Brothers' calculation the multiple of corporate liquidity to quarterly business investment had dipped from a high of more than 15 in 1988 to under 13 by the end of 1990; other data suggest that the ratio has continued to fall this year. In late September Nihon Keizai Shimbun, the big Japanese economic daily, reported that large Japanese companies even were resorting to selling some of their financial crown jewels -- expensive Tokyo real estate -- in an effort to raise funds. Sapporo Breweries Ltd., for example, was hoping to raise Y100 billion ($740.7 million) in this way. In short, financing investment has become a difficult proposition in the early 1990s in Japan.

Despite these problems, forecasts of corporate plant and equipment spending for the April 1991-March 1992 fiscal year are relatively rosy. On the same day that the Economic Planning Agency announced that seasonally adjusted real plant and equipment spending declined in FY 1991's first quarter from the last three months of FY 1990, the Japan Development Bank announced the results of its August survey of corporate investment intentions for all of FY 1991. The JDB survey suggested that capital spending could rise 10.7 percent over FY 1990's level, a healthy jump even if one shaves off about 1.5 percentage points to account for higher capital goods prices.

The JDB survey results are in line with other recent surveys. For example, a mid-September survey conducted by Nihon Keizai Shimbun showed that large firms expected to spend 7 percent more in FY 1991 on plant and equipment than in FY 1990. If firms realize these forecasts, the growth in capital spending would be far below the 16.5 percent nominal jump registered in FY 1990, although still strong by almost all standards. Nevertheless, both the JDB and the Nikkei surveys probably incorporate firms' expectations that interest rates will drop significantly; at this juncture that result is not guaranteed.

Over the longer term additional factors will affect both savings and investment in Japan. One factor that may be less of a drain on savings than it would appear at first glance is the country's changing demographic profile. The average age of the population is advancing rapidly, in part because the elderly are increasing in numbers and in part because relatively few children are being born (see JEI Report No. 46A, December 7, 1990). This development could portend a decline in savings since the group that typically has high savings (those aged 35 to 44) is shrinking in relative size.

Recent research, however, casts some doubt about a marked demographic impact on savings rates. The decline in savings in Japan as shown in Table 1 and Figure 1 represents a drop in the savings of each age group and is not the result of shifting demographics, according to two researchers from the Brookings Institution and one from Towson State University.[12] The future could resemble the past in this respect. Nor will Japan's increasing numbers of elderly necessarily pull down the savings rate as much as once thought. Recent research suggests that the elderly may well avoid dissaving.[13] However, their savings rate probably will drop compared to their wage-earning years.

Many experts remain convinced, however, that demography has been and will continue to be important in explaining Japan's savings rate. Charles Yuji Horioka of Osaka University examined over 30 factors, including those relating to the age distribution of the population, in an effort to explain Japan's relatively high personal savings rate. He concluded that demographic shifts belong in the group of important factors and that the personal savings rate will drop significantly over the next decade as the population ages.[14]

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[12] Barry Bosworth, Gary Burtless and John Sabelhaus, "The Decline in Saving: Evidence from Household Savings," Brookings Papers on Economic Activity, 1991, I, pp. 183-256.

[13] See Robert Dekle, "Do the Japanese Elderly Reduce Their Total Wealth? A New Look with Different Data," The Journal of the Japanese and International Economies, September 1990, pp. 309-317.

[14] Horioka, op. cit., p. 85.

More of a consensus may exist for the role that demography will play in investment patterns. A decline in the number of new entrants in the labor force after 1992 and a probable drop in the total size of the labor force by the turn of the century imply that demand for plant and equipment spending will rise as firms attempt to substitute capital for labor. This trend would accelerate the process described earlier and could result in the capital-output ratio rising even further -- to the extent that firms can find the savings and can afford to fund such a substitution.

Both the (possibly) shrinking supply of savings and the surging demand for investment are likely to result in upward pressure on Japanese interest rates during the rest of this decade. To the extent that Japan's capital market is integrated with those abroad, interest rates may rise only modestly there. In that case, however, Japan's supply of surplus savings to overseas markets could shrink significantly.

Conclusion

Although some experts regard Japan's savers as the not-so-secret weapon that has enabled the Japanese economy to grow rapidly during much of the postwar period, the reality is more complicated. Once adjustments are made to the personal savings rate, differences between Japan and the United States -- two countries with seemingly very different savings rates -- narrow, although a gap still remains. Moreover, other aspects of Japan's savings picture, including business and government savings, plus an unusually close linkage between savings and investment until a decade ago, also have played a major role in Japan's ability to invest in plant and equipment; this, in turn, has had the effect of boosting economic growth.

In coming years Japan will not enjoy the same advantages arising out of its high savings rate as it did in the past. The increasingly international demeanor of capital markets will draw savings out of Japan as never before in response to what appear to be tiny interest rate differentials. This will reduce the pool of domestic funds that Japanese firms can tap. Japan's aging society will increase the demand for investment funds over the rest of this century at the same time that the country will face the possibility of a declining supply of savings. Long-term trends suggest that investment funds will not have the same effect on output as they did previously. In short, while Japan's households may well remain world-class savers, their savings will not appear as abundant as they have in the past.

For further information, contact Douglas Ostrom.

Dean Rogers provided research assistance.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

NOTE

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JEI

REPORT

A Two-Part Report: A and B

NO. 38A

October 11, 1991

JAPAN'S DEFENSE PROCUREMENT AND PLANNING COMPLICATED BY GLOBAL CHANGES

Summary

The people who drafted Japan's current five-year defense plan saw changes in the global order occurring as they worked to gain cabinet approval for the program late last year, but they scarcely could have expected the new upheavals in the wake of the August 1991 aborted coup d'etat in the Soviet Union. Neither could they have foreseen the recent, related announcements in Washington and Moscow that they would eliminate most of their tactical nuclear weapons; such a move would further propel the transition to a new world order. While the five-year defense program is not necessarily outdated, planners will be closely following these changes, which appear to affect the decades-long threat posed by Soviet military power in the Far East -- a threat that has shaped Tokyo's security strategy.

In the immediate future defense experts do not anticipate dramatic changes in the FY 1991-FY 1995 defense program. Tokyo continues to be wary that whatever remains of the Soviet Union still may have potential designs in the Asian Pacific because, unlike in the European theater, Moscow has continued qualitative upgrades of its weaponry in this region. There also is concern that the breakdown of the Cold War superpower balance will create the potential for regional instability, particularly in Asia, for which Japan does not want to be ill-prepared. But as East-West tensions continue to ease and Japanese-Soviet relations presumably improve, Japanese defense officials acknowledge that they will face virtually unavoidable domestic pressures to constrain still further the growth in the defense budget.

At the same time Tokyo will be compelled by both internal and external forces to pursue a more engaged foreign policy;

that, in turn, may necessitate reinterpreting its self-defense mission in a more expansive manner. This may culminate in Japan's decision to allow Self-Defense Forces personnel to participate in United Nations-sponsored peacekeeping efforts. Although the U.S.-Japan Mutual Security Treaty will remain a crucial pillar of the bilateral alliance, transpacific frictions will continue over equipment procurement and military technology transfers due to the clash of budgetary constraints in both Tokyo and Washington, the Japanese defense industry's aspirations and U.S. defense manufacturers' efforts to adapt to a shrinking global defense market.

Tokyo Slows Defense Buildup in FY 1991-FY 1995 Plan

By the time Soviet communist hard-liners had attempted and failed to overthrow the government of Mikhail Gorbachev this past August, Tokyo was in the first year of its FY 1991-FY 1995 defense buildup program -- a plan that incorporates some reevaluations of Japan's security requirements in light of post-Cold War changes. Japan's defense buildup program, begun in 1977, has been developed and implemented in accordance with the National Defense Program Outline. This overarching plan, adopted in October 1976 by the cabinet of then Prime Minister Takeo Miki, stipulates the level of defense capabilities that should be maintained by Japan in peacetime and provides guidelines for improvement. Among the emphasized goals are improved and expanded capabilities in air defense, antisubmarine warfare and ground force response to a manned invasion as well as improved command, communications, intelligence and reconnaissance capabilities. By the end of FY 1990 Tokyo had accomplished most of the personnel and equipment procurement objectives contained in the 1976 outline (see JEI Report No. 35A, September 14, 1990).

When Japanese defense planners sat down in the summer of 1989 to begin to pull together proposals for the FY 1991-FY 1995 program, they faced the difficult task of having to develop a new conceptualization of Japan's security needs amid a changing global backdrop. The underlying premises of its self-defense vision had been the need to preserve a military balance between the United States and the Soviet Union and the related desire to prevent a full-scale attack against Japan through adherence to the U.S.-Japan Mutual Security Treaty. But at the end of the 1980s, as the Kremlin's shadow over Eastern Europe rapidly began to fade and as U.S.-Soviet relations entered a more cooperative period, the very context in which Japan's military roles and missions had been determined was in flux.

Washington added to the unsettled feeling in Tokyo when it announced a plan in February 1990 to reduce by one-tenth the American forces stationed in Japan and elsewhere in Asia during the 1990-93 period (see JEI Report No. 9B, March 2, 1990). Although this move was influenced more by budgetary constraints than a reassessment of the Soviet military threat to the Asian Pacific, domestic critics of Japan's defense posture seized on this action as justification

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to similarly reduce their country's military power. Since the postwar global order was evolving in a new direction, their argument went, the 1976 defense outline and the self-defense goals set forth under this plan no longer were relevant.

The Japan Defense Agency, in concurrence with the Department of Defense, strongly refuted these claims, citing intelligence estimates concerning Soviet military personnel and weaponry stationed in the Far East. The political and economic reforms sweeping through the Soviet bloc at that time did not lessen Moscow's ability to pose a threat to Asian stability, defense officials emphasized. A report issued in July 1990 by Japan's National Security Council, a panel comprised of the prime minister and selected cabinet officials who deliberate on defense-related issues, in fact urged that the upcoming defense plan pick up where the old framework left off in terms of modernizing the Self-Defense Forces and qualitatively improving weapons systems (see JEI Report No. 35A, September 14, 1990). Some Japanese defense officials also pointed out that even with completion of the FY 1986-FY 1990 program and attainment of most of the outline's objectives, Japan's military still would not be able to adequately defend the sea-lanes stretching 1,000 nautical miles east and south of the country. (Former President Reagan and then Prime Minister Zenko Suzuki established this as a self-defense goal for Japan in a 1981 joint communique.)

NSC members therefore recommended the procurement during the FY 1991-FY 1995 period of several advanced systems to further enhance Japan's capabilities in air defense and ground force response plus improvements in command, communications, intelligence and reconnaissance. Some of the hardware specifically mentioned included AWACS (airborne warning and control system) aircraft, the multiple-launch rocket system, tanker-refueling aircraft and Aegis radar-linked fire-control systems. The report also urged that money be appropriated to establish a new headquarters for gathering and analyzing intelligence data. In a continuing effort to attract talented individuals to the military the drafters of the NSC report called for improved living and working conditions for SDF members.

When the Japan Defense Agency subsequently began negotiations with the Ministry of Finance on the budget that would be needed to implement some of the NSC's proposals, MOF -- which has not been known for its largesse in budget talks with any ministry -- appeared unimpressed by JDA's assessment that the continuing Soviet threat justified additional monies to procure advanced weapons systems. Even more unfortunate from the defense agency's standpoint, the Finance Ministry enjoyed the support of Prime Minister Toshiki Kaifu on this issue. Although a participant in the NSC, Mr. Kaifu nevertheless felt that the thaw in East-West relations warranted a more restrained Japanese defense effort. Referring to JDA's proposed 6 percent spending hike for FY 1991, the first year of the new program, the prime minister charged that this was an "unacceptable" request in light of improved U.S.-Soviet relations and fiscal realities.

Perhaps influenced by the military-restructuring decisions of the United States and other allies, Mr. Kaifu advised JDA in late July 1990 to take into account "changes in the international situation" in drawing up the FY 1991-FY 1995 defense program. "[T]he perception of the international situation by the European countries has changed much," the prime minister was quoted as telling defense officials. "I hope future [Japanese defense] policy and [defense] white papers will be based on this point." His approach clearly questioned the need for a large increase in Japan's defense budget when Western allies appeared to be cutting theirs.

Since defense spending never has been politically popular in Japan, Mr. Kaifu's alliance with tight-fisted MOF on this issue lowered the boom on JDA's hopes for realizing certain improvements in the weapons area. Budgeted at Y22.8 trillion ($168.9 billion at Y135=$1.00), the new five-year defense program, which was approved by the cabinet in December 1990 and went into effect April 1, 1991, generally will hold annual spending increases to a mere 3 percent before adjustment for inflation. This is well below the 5.4 percent average yearly hike JDA enjoyed under the FY 1986-FY 1990 plan. In an apparent effort to strike a compromise between JDA and proponents of a scaled-back defense program, the Japanese government also decided to subject the plan to a review after three years. This gives defense planners greater flexibility to augment or cut back military capabilities in response to changes in regional or global security environments.

Although the budget for new equipment will decrease by an estimated 2.3 percent a year on a contract basis through FY 1995 (see Table 1), JDA still was able to secure authorization for some of the advanced weapons systems recommended by the NSC. These include 36 vehicle-mounted multiple-launch rocket systems, four AWACS and two Aegis destroyers (see Table 2). As a result of these planned big-ticket purchases, the pace of tank and destroyer purchases will slow. JDA officials have emphasized, however, that actual combat capabilities in these areas will remain at about the same level because the advanced Type-90 tank and the Aegis destroyer will more than compensate for the retirement of their predecessors.

Table 1: Japan's FY 1991-FY 1995 Defense Program

Category	Amount (trillions of yen)	Percentage Distribution	Annual Growth (in percent)
Total Spending	Y22.75	100.0%	3.0%
Personnel Costs	8.50	37.4	0.6
Equipment Purchases	5.10	22.4	2.1
(purchases on contract basis)	(5.0)	---	(-2.3)
Rear Support	9.15	40.2	5.9

Source: Japan Defense Agency

Sacrificed from the "wish list" due to projected budget constraints were tanker-refueling aircraft and over-the-horizon radar. Domestic and regional concerns that this high-priced, sophisticated equipment would endow Japan with too great a power projection capability also evidently gave impetus to their deletion from the new plan.

Table 2: Planned Major Japanese Equipment Purchases, FY 1991-FY 1995

Item	Quantity to be Procured
Ground Self-Defense Force	
Tanks	132
Artillery Pieces	716
Multiple-Launch Rocket Systems	36
Armored Personnel Carriers	218
Ground-Based Antiship Missiles	40
Antitank Helicopters (AH-1S)	20
Transport Helicopters (CH-47J)	14
Surface-to-Air Guided Missiles (improved HAWK)	2.5*
Maritime Self-Defense Force	
Destroyers	10
Submarines	5
Auxiliary Ships	20
Antisubmarine Patrol Aircraft (P-3C)	8
Antisubmarine Helicopters (SH-60J)	36
Minesweeping Helicopters (MH-53E)	1
Air Self-Defense Force	
Fighter Aircraft (F-15)	42
Transport Aircraft (C-130H)	3
Transport Helicopters (CH-47J)	2
AWACS	4
Intermediate Training Aircraft (T-4)	90
Surface-to-Air Guided Missiles (Patriot)	1*

*Missile groups

Source: Japan Defense Agency

Responding to U.S. requests that Tokyo underwrite a greater share of the mutual defense burden, Japanese defense planners also reordered the budget for the FY 1991-FY 1995 period to enable Tokyo to cover approximately 50 percent of the roughly $6 billion annual cost of maintaining American forces in Japan; this represents a 10 percentage point increase (see JEI Report No. 48B, December 21, 1990). The Y8.5 trillion ($63 billion) earmarked for personnel-related expenses in the current defense plan will go toward upgrading living and working quarters for SDF members, primarily as a way to improve recruitment. Personnel is the one area of the 1976 outline in which Japan still falls short (see JEI Report No. 35A, September 14, 1990).

Illustrating the extent to which progress in U.S.-Soviet affairs affected the cabinet's assessment of Japan's near-term security needs, senior government officials decided to cap the increase in JDA's budget for FY 1991 at the lowest year-to-year level in 30 years. When then JDA director general Yozo Ishihara initially conferred with Finance Minister Ryutaro Hashimoto in July 1990 about defense funding for the first year of the new five-year plan, he requested a 6.3 percent increase. By the time the cabinet approved in late December the Y4.4 trillion ($32.5 billion) defense budget for the current fiscal year, this level had been reduced to 5.5 percent.

While this amount exceeded the 3 percent average annual increase envisioned in the new defense plan (and enabled JDA to shoulder higher personnel-related costs and make payments on earlier hardware contracts), the restraint on spending increases has forced JDA to delay until at least FY 1992 procurement of some advanced, big-ticket hardware, such as AWACS and the multiple-launch rocket system. JDA officials, who evidently anticipated a tough fight with MOF, warned their Pentagon counterparts as early as August 1990 that it would be difficult in the immediate future for the agency to acquire some advanced weapons systems that defense officials in both countries consider necessary.

JDA Proposes Staying the Course in FY 1992

JDA, in effect, set the stage this year for discussion of its budget proposal for the April 1992-March 1993 period with the release of its annual white paper in July. The 1991 white paper deleted a decade-old reference to the "latent Soviet threat" to regional security but urged continued vigilance -- and a continuation of current military spending levels -- because of Moscow's still formidable forces arrayed in the Asian Pacific.

The white paper acknowledged that the Soviet Union now is in a difficult position to stage aggressive actions against other countries because of its domestic economic and political problems as well as the loss of a support network when its former satellites in Eastern Europe embraced political and economic reforms outside of Moscow's sphere. Nevertheless, during the past two years, JDA maintained, Soviet forces in the Far East have been steadily "reorganized, streamlined and modernized." Such "massive deployment" in the Asian Pacific far exceeds what the Soviets need for self-defense, the white paper stated. The defense document therefore warned that Soviet forces will continue to bring tension to areas surrounding Japan. JDA also gave greater emphasis to the potential for regional instability -- with, or without, provocation from Moscow, citing the Cambodian civil war and the perception of a militaristic venue being pursued by North Korea. In short, the defense agency's bottom line on the Asian Pacific security situation remained unchanged; the Cold War has not thawed in this region as much as it has in Europe, so Japan should not let down its guard (see JEI Report No. 31B, August 16, 1991).

JDA's draft budget request for FY 1992, not surprisingly, reflects the view that Tokyo should stay the course in terms of implementing the FY 1991-FY 1995 defense program. Its Y4.6 trillion ($34.2 billion) proposal, submitted to MOF in late August, represents a 5.4 percent increase over the initial budget for the current fiscal year. As drafted, the proposal for the second year in a row gives greater priority to troop support and less to equipment procurement. The Y1 trillion ($7.5 billion) penciled in for hardware purchases would represent a 4.8 percent decrease from FY 1991; the nearly Y1.8 trillion ($13 billion) requested for personnel and operations would represent an 11.7 percent increase.

In addition to JDA's continuing desire to improve living and working conditions for Japanese military personnel, this proposed breakdown may have been influenced by U.S. pressures on Tokyo to assume more of the costs for maintaining U.S. forces stationed in Japan -- what is referred to as host-nation support. For the past several years American legislators, in particular, have argued that Japan should be sharing more of the mutual defense burden, given its economic strength. They have zeroed in on host-nation support, with some members of Congress arguing that Tokyo should bear 100 percent of the direct costs of maintaining U.S. troops on Japanese soil. While the Japanese government has countered that these demands exceed what it legally may do under the 1960 Status of Forces Agreement (see JEI Report No. 38A, October 6, 1989), defense officials have promised in talks with their American counterparts to push for increased support for U.S. forces within the legal limits.

Despite the reduction in monies for equipment purchases, JDA proposed following through in the coming fiscal year on the acquisition of some big-ticket items that the agency had to forgo in FY 1991. The Y1.6 trillion ($12.2 billion) suggested for the Ground Self-Defense Force would enable JDA to purchase from defense contractor LTV Corp. nine multiple-launch rocket systems for Y24.1 billion ($178.5 million) and 28 Type-90 tanks, made by Mitsubishi Heavy Industries, Ltd., at a cost of Y30.6 billion ($226.7 million). JDA would like to procure for the Maritime Self-Defense Force two 4,400-ton-class destroyers for Y147.8 billion ($1.1 billion) and two P-3C antisubmarine warfare helicopters, produced under license from Lockheed Corp. by Kawasaki Heavy Industries, Ltd., at an estimated cost of Y23.4 billion ($173.3 million). As for the Air Self-Defense Force, the defense agency has requested funding for three Raytheon Co. Patriot surface-to-air missile batteries for Y103.8 billion ($768.9 million) and 11 General Dynamics Corp. F-15 fighter aircraft, which are licensed for production by MHI, for Y113.7 billion ($842.2 million).

The requested procurement of the Patriot missiles and the Type-90 tanks was carried over from the current fiscal year. The purchase of these weapons was delayed because the initial allocation for FY 1991 defense spending had to be reduced by Y100 billion ($740.7 million) to free up funds for the $9 billion pledged by Tokyo in January to assist the multilateral forces that fought in the Persian Gulf War (see JEI Report No. 7B, February 22, 1991).

Other major weapons acquisitions proposed for purchase in FY 1992 include: eight Type-88 surface-to-surface missiles; 20 batteries of Type-91 shoulder-firing surface-to-air missiles; five CH-47J helicopters made by Boeing Co.; 15 OH-6D helicopters, produced under license from Hughes Aircraft Co. by KHI; 10 AH-1S antitank helicopters, produced under license from Bell Helicopter Textron Inc. by Fuji Heavy Industries, Ltd.; 17 HU-1H helicopters produced under license from Bell by FHI; a 4,000-ton training vessel; and 25 T-4 fighter aircraft trainers made by KHI.

Joint Development Prospects Fuzzy

The defense agency also is seeking Y192.9 billion ($1.4 billion) for research and development in FY 1992 in line with its plan to double by the end of the current defense plan the 2.5 percent share of the budget now devoted to R&D. Representing a significant break from past practice, however, JDA director general Yukihiko Ikeda, in outlining the guidelines for the FY 1992 budget to aides and defense-related officials of the ruling Liberal Democratic Party, emphasized the importance of promoting cooperation with the United States in military-related R&D.

People who say that Japan and the United States are unwilling or unable to collaborate in studying advanced technologies are overstating the situation; the work of the 13-year-old bilateral Systems and Technology Forum indicates otherwise. At a late September S&TF meeting in Tokyo, for example, the two governments agreed to jointly research and develop a solid fuel-burning ducted rocket engine. This project actually is an outgrowth of the group's decision last year to establish joint working groups in five areas of advanced defense technology. By enabling American and Japanese representatives to identify mutually beneficial cooperative projects, the working group approach would enable both nations ultimately to lower the costs of defense systems and maximize technological resources, participants maintained.

Notwithstanding the efforts of S&TF and Mr. Ikeda's intention to foster greater transpacific cooperation, misgivings on the part of government and industry in both countries have limited joint R&D work on defense technologies. This situation is unlikely to change in the short run, given the bitter 1987-89 controversy surrounding the FSX, Japan's next-generation fighter support aircraft (see JEI Report No. 21A, May 26, 1989).

The FSX project is at least two years behind schedule. Disagreements between Washington and Tokyo delayed its start, but a bigger factor was the long time it took for General Dynamics, the builder of the F-16 on which the FSX is modeled, and prime contractor MHI to work out a project agreement. Washington's strict limits on the transfer of F-16 technology to Japan also has slowed progress because MHI has to design and develop on its own key parts of the FSX's airframe and electronics systems. This work is a major reason projected development costs have nearly doubled from an original estimate of Y165 billion ($1.2 billion) to Y310 billion ($2.3 billion).

To help defray rising program costs JDA incorporated an additional Y83 billion ($614.8 million) in its FY 1992 budget request for the FSX. The defense agency also is being forced to make some additional equipment purchases and modifications to compensate for the problems with the FSX timetable. Next year's request for 11 more F-15s is a contingency measure. The Air Self-Defense Force also has decided to modernize its three squadrons of MHI-built F-1 aircraft because of the delays in FSX development. Over the next two years the aircraft will be retrofitted with advanced antiship missiles and improved fire-control systems, among other features.

Although behind schedule, FSX work basically is on track. In July MHI signed its first major contract with General Dynamics, the prime subcontractor, covering $110.7 million of the estimated $800 million in development work that the U.S. defense contractor expects from this phase of the FSX program. Of the 300 engineers working on the project at MHI's Nagoya plant, approximately 60 are American, according to General Dynamics officials.

Despite these signs of progress, some analysts fear that the acrimony generated by the FSX deal has soured prospects for future joint development work. "FSX hangover," as it sometimes is called, also could bolster the case of U.S. policymakers and others who contend that Japan, for reasons related primarily to its trade imbalance with the United States, should buy new weapons systems from American defense contractors rather than develop the hardware by itself or manufacture it under license.

Japanese defense officials got a fresh reminder of this point of view earlier this year. JDA wanted to buy nine of the 36 multiple-launch rocket systems planned for acquisition over the course of the FY 1991-FY 1995 plan off-the-shelf and have a Japanese company (Nissan Motor Co., Ltd.) produce the remaining 27 units under license from LTV. The Dallas-based company evidently insisted that this relatively small order did not warrant a licensing arrangement; a contract for around 150 units might, however. Given the fluid international environment and the Japanese government's plan to reassess the current defense plan after three years, JDA would not commit to more than 36 MLRS units through FY 1995. The defense agency eventually agreed to purchase all 36 units off-the-shelf, leaving open the possibility that the system may be licensed for domestic production during the FY 1996-FY 2000 program.

While this move avoided another bilateral flap, JDA's decision to seek Y3 billion ($22.2 million) in FY 1992 for basic design work on the GSDF's next-generation light observation helicopter -- dubbed OHX -- has sparked an outcry from some U.S. quarters reminiscent of the FSX controversy. The OHX would replace approximately 180 aging OH-6Ds made by KHI under license from McDonnell Douglas Helicopter Co. The next-generation helicopter will be equipped with what has been described as an integrated, infrared-television-laser reconnaissance and observation system. Basic design and development costs are expected to run anywhere from Y60 to Y80 billion ($444.4 to $592.6 million). A GSDF source has been quoted as saying that JDA would like work to start on the prototype in FY 1993 so procurement could begin from FY 1997 and possible deployment start in FY 1999.

At least one U.S. firm, Sikorsky Aircraft Co., lobbied JDA to be included in the OHX project. According to Stanley P. Krueger, president of international operations in Japan for Sikorsky's parent firm, United Technologies Corp., the subsidiary was a logical and attractive candidate for joint development and production. Earlier this year the Stratford, Connecticut-based company was tapped by the U.S. Army along with Boeing to develop the Comanche, the army's new light attack helicopter. "It's not difficult to suggest that the technology developed for the [Comanche] might be applied to the OHX," Mr. Krueger reportedly stated.[1]

The U.S. Army tried to work the other side of the coin, coopting Japanese manufacturers to work with Sikorsky and Boeing on the Comanche. Codevelopment and coproduction of the Comanche would afford Japan and other allies a cost-effective opportunity to take advantage of technical advancements, army officials maintained. According to the army's former manager of the Comanche project, retired Maj. Gen. Ronald Andreson, the army wants to purchase more than 1,292 light attack helicopters in the late 1990s and beyond for around $35 billion. If the Sikorsky-Boeing team turns out 120 helicopters a year, the cost of each Comanche is expected to be $7.5 million, a value not possible in any other country since no one else plans to buy that many helicopters at that rate, Mr. Andreson contends.[2]

At this stage in the budget compilation process, however, JDA remains committed to indigenous development. Sikorsky's conversations with all the appropriate Japanese government and industry officials appear to have been in vain, as does the army's attempt to interest the Japanese in the Comanche project. Some Japanese defense officials justify JDA's approach on the grounds that the Comanche is designed as an offensive weapon, which would not appropriately serve -- or legally serve, some might argue -- Japan's purely self-defense mission. Thus, "if the U.S. has no substitutes, we must develop the helicopter by ourselves," says Ryozo Tsutsui, a former defense official.[3] Comments such as Mr. Tsutsui's have revived FSX-type arguments in the United States to the effect that Japan would prefer to selfishly guard its technological advances even though American defense contractors, through licensed production arrangements, have been willing to transfer the fruits of their labors.

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[1] Nobuyuki Oishi, "U.S. Contractors Hit By FSX Fallout," Nikkei Weekly, September 21, 1991.

[2] Caleb Baker, "U.S. Army Eyes Japanese Help On Comanche Production," Defense News, July 29, 1991, p. 3.

AWACS Flap Highlights Defense/Economics Linkage

While Tokyo's handling of the MLRS and OHX/Comanche issues generally has not played well in the American defense community, JDA's decision to eliminate funding from its FY 1992 budget request for the two AWACS it had planned to procure (two more would be purchased in FY 1993) risks becoming a full-blown bilateral dispute. The reason for the brouhaha has as much to do with perceptions of Japan's self-defense needs as it does with the bilateral trade imbalance. The apparent controversy-in-the-making illustrates the extent to which the defense and economic aspects of U.S.-Japan relations have become linked.

From a purely business perspective the defense agency's reasons for not going ahead with the AWACs purchase are understandable. Boeing, which makes the sophisticated surveillance aircraft, more than doubled the plane's price after JDA incorporated the AWACS acquisition into its FY 1991-FY 1995 plan. The aerospace giant reportedly has quoted a new per-plane price of Y70 to Y80 billion ($518.5 to $592.6 million), compared with the Y30 billion ($222.2 million) figure JDA had used last year in pulling together the current five-year defense plan. The price soared after Congress scrapped a plan to sell 11 of the Boeing 707-based planes to Saudi Arabia and the Seattle-based company announced plans to shut down its AWACs assembly line. The price quotes that Boeing presented to JDA last year were based on a production run of at least 14 planes. Reopening the line for just four planes would jack up the price considerably.

Some Japanese defense officials believe that before the cabinet's year-end approval of the FY 1992 budget the AWACS or another type of surveillance aircraft once again may show up in the defense plan. For example, there are reports that JDA may be considering an upgraded E-2C, a small, propeller-driven early warning aircraft, as an alternative to the AWACS.[4] But defense experts in both countries caution against exploring alternatives because oftentimes the resulting purchase is not exactly what was wanted or really needed. No other model quite matches the Boeing-made aircraft's capabilities, they maintain.

As with the FSX deal, congressional pressure may force both parties to reach some sort of agreement. Some 64 members of the House of Representatives wasted little time in firing off a letter to Prime Minister Kaifu in late September, charging that Tokyo is reneging on former Prime Minister Suzuki's promise in 1981 to purchase AWACS as part of Japan's 1,000-nautical-mile self-defense effort. Tokyo should not go back on its word even though the global security environment is changing, they asserted. While acknowledging that the cost of the aircraft has risen dramatically, the members argued that JDA's decision to eliminate the AWACs from its FY 1992 procurement plans "would be inconsistent with U.S.-Japanese traditions of mutual cooperation." U.S. government sources suggest that at this stage both sides are considering the feasibility of extending AWACS procurement into the next five-year plan to accommodate Tokyo's possible budgetary adjustments.

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[3] Oishi, op. cit.

[4] Naoaki Usui, "Japan Cuts AWACS, Funds New Copter In '92 Budget Plan," Defense News, August 26, 1991, p. 1.

As happened when Congress considered the FSX deal, Japan's hefty trade surplus with the United States -- $38 billion in 1990 -- continues to affect how some legislators view Japan's responsibilities as an ally, responsibilities which some view as ameliorating the trade imbalance as well as supporting U.S. defense contractors scrambling for a piece of a shrinking global business. As long as economic competition between the two countries remains intense, certain members of the American defense community, supported by some U.S. legislators, will fight Japanese defense industry efforts to develop indigenous military technologies and equipment.

The pressure, however, has begun to backfire in Japan. "The U.S. doesn't play fair," an unnamed industry executive involved in the FSX project recently was quoted as saying. "I never want to do a development project with the Americans again," he reportedly said.[5] While this person does not speak for the whole industry, his statement suggests that congressional initiatives, such as the recent letter to Mr. Kaifu on the AWACS purchase, actually may give further impetus to Japanese efforts to go it alone. In coming years, no doubt, the link between bilateral trade and U.S.-Japan defense cooperation will become more prominent.

Global, Regional Changes Affect Japan's Defense Responsibilities

At about the same time that the defense agency released its FY 1992 draft budget, Soviet communist hard-liners attempted to stage a coup d'etat. The chain of events precipitated by their failure to overthrow the government of President Gorbachev has altered still further the global order in which Japan's security needs and defense roles and missions have been determined for the past 46 years. As a result, Japan's political opposition and perhaps certain elements within the ruling LDP may press for a further scaling back of Japanese defense spending in the later years of the current five-year plan. Depending on JDA's assessment next year of the regional security situation, there also might be moves to eliminate proposed acquisitions of certain expensive, technologically advanced hardware.

Near-Term Impact of Soviet Developments - Most Japanese defense analysts concur that the Japanese government generally will stick with the FY 1992 spending plan proposed by JDA. While the Ministry of Finance rarely grants government ministries and agencies exactly what they ask for in August, MOF's inevitable trimming of JDA's FY 1992 budget request should not be so severe as to undermine equipment procurement and personnel needs for the next fiscal year.

[5] Oishi, op. cit.

As one Japanese defense official pointed out, "No matter what is happening elsewhere in the world, Japan must maintain the defense capabilities necessary to enable it to effectively repel small-scale aggression -- this is a basic tenet of the self-defense mission." A dramatic departure from the current defense plan could undermine this capability, he explained.[6]

Moreover, some Japanese feel that there still are too many uncertainties in the Soviet Union. Cognizant of the modernized Soviet troops and equipment in the Far East, Japanese defense officials view with some skepticism the assertion that conservative Soviet elements have been rendered ineffective by the dramatic course of events following the late August coup attempt. They urge continued qualitative improvements in Japan's military capabilities and close cooperation with the United States.

Of perhaps even greater concern to Japanese public- and private-sector officials are the regional repercussions of the demise of the Cold War order. While Tokyo has reacted in a measured manner to the Philippines Senate's rejection of an agreement allowing the U.S. military to stay at the Subic Bay Naval Station (see JEI Report No. 36B, September 27, 1991), some Japanese analysts are apprehensive that potentially volatile developments in the Philippines could spill over into the rest of the Asian Pacific once the stabilizing influence of an American troop presence is withdrawn.

Jin Murai, an LDP member of the Diet's lower house, believes that the East-West superpower conflict contained many ethnic and economic problems. The breakdown of Soviet central government control, in effect, has opened a "Pandora's box," creating highly uncertain dynamics in the neighboring region, Mr. Murai maintains. "What will happen in China when Deng [Xiao Ping] dies? How about Kim Il Sung in North Korea? With the end of the Cold War we will see the commencement of 'hot wars' in Asia and elsewhere," he contends.[7] Mr. Murai's remarks suggest that the continued improvement of Japan's defense capabilities remains just as important, if not more so, as the global system undergoes transition.

Even before the attempted Soviet coup Tokyo was concerned about potential regional instability. In July Foreign Minister Taro Nakayama proposed the establishment of regular, high-level meetings among senior government officials from Asian Pacific countries to discuss security policy, with the goal of facilitating an exchange of security-related information and ideas. Mr. Nakayama unveiled this proposal at a ministerial meeting of the six-country Association of Southeast Asian Nations (see JEI Report No. 29B, August 2, 1991).

Japanese government officials have emphasized that what the foreign minister is proposing is by no means an Asian equivalent to the North Atlantic Treaty Organization or the Conference on Security and Cooperation in Europe. Rather, Tokyo is highly concerned about the power vacuum that it believes will develop in the Asian Pacific with the restructuring of U.S. forces and the presumed reduction of the Soviet military presence. As Mr. Murai mentions, Japanese officials are worried particularly about the behavior of China and North

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[6] Interview with Shinshiro Yamazaki, Defense Facilities Administration Agency, Japan Defense Agency, September 4, 1991, Tokyo, Japan.

[7] Interview with Jin Murai, Japanese Diet, House of Representatives, September 10, 1991, Tokyo, Japan.

Korea, two countries that were conspicuously quiet during the recent upheaval in the Soviet Union.

For this reason Japanese officials have been reluctant to speculate about the impact on the global security environment -- and Japan's related defense role -- of President Bush's late September plan to eliminate almost all U.S. tactical nuclear weapons and a similar proposal subsequently unveiled by President Gorbachev. Although Mr. Kaifu praised the American president for his "bold and courageous initiative," there is a view in Tokyo that the true regional impact of the dramatic American and Soviet announcements cannot be known with any degree of certainty until Asian countries with nuclear capabilities -- that is, China and, presumably, North Korea -- respond in kind. The U.S. proposal, in particular, makes it more difficult for Pyongyang, a 1985 signatory to the Nuclear Nonproliferation Treaty, to continue to refuse inspection of its nuclear facilities by the International Atomic Energy Agency. North Korea's pretext for not agreeing to on-site inspections has been the suspected presence of U.S.-built short-range nuclear weapons in South Korea. In the near future this no longer would be a factor. Nevertheless, Japanese government officials suggest that the unpredictable and potentially problematic situation on the Korean Peninsula compels Tokyo to hold firm to its defense plans.

The Japanese press also has suggested that President Bush's proposal could pave the way for a new bilateral defense arrangement. This is unlikely, government officials on both sides of the Pacific maintain. For one thing, President Bush contacted the leaders of Japan, Australia, South Korea and other Asian Pacific nations soon after he announced his plan to assure them that Washington's commitment to these nations' security and well-being remained "rock solid." Second, the U.S.-Japan Mutual Security Treaty, in particular, is viewed by virtually all the regional players as an arrangement that benefits everyone. Its deterrent nature has served to discourage military adventurism by Moscow, Beijing, Pyongyang and others. Moreover, for countries that suffered under Japanese colonial rule prior to 1945, the MST framework is viewed as restraining Japanese militaristic behavior. "Japan is one of Korea's major concerns, especially Japan's defense role," says Cha Young Koo of the Korea Institute for Defense Analysis. "The [MST's] function of restraining Japan's military . . . is becoming more and more important," he contends.[8]

Global Developments Require Redefining Defense Role - As the post-Cold War order continues to evolve in the coming months and years, discussions in Tokyo will focus not only on defense spending levels and equipment needs but the nature of Japan's self-defense mission. With the country's emergence as a major economic power, Tokyo's friends increasingly have criticized Japan's apparent unwillingness to assume greater political responsibilities outside its immediate sphere. When Iraq invaded Kuwait in August 1990 and Washington called for contributions to the allied military effort to redress this aggressive action, Japan's offerings of financial assistance were called too-little, too-late and provoked charges from some American policymakers that Tokyo wanted only to "hide behind its peace constitution." (Article 9 of Japan's 1945 constitution is a war-renouncing clause that has been interpreted as banning the overseas dispatch of military personnel -- see JEI Report No. 13A, April 5, 1991.)

[8] George Leopold, "Cold War Leaves Legacy of Instability in Asia," Defense News, September 30, 1991, p. 6.

The Persian Gulf War, perhaps even more than the easing of East-West tensions, has compelled Tokyo to deliberate how its self-defense laws and constitutional provisions should be reinterpreted in light of dramatic global changes and Japan's stature within the emerging new world order. This process has not been easy; for 46 years Japan's foreign policy has been limited to nonmilitary involvement outside its home waters. Not surprisingly, Tokyo's initial effort to develop a means by which Japan could provide unarmed support to allies engaged in a foreign conflict situation failed -- due, in part, to a consensus gap between what the government wanted to do and what the public and Southeast Asian neighbors were willing to support (see JEI Report No. 44B, November 16, 1990).

The victory of the coalition forces in the Persian Gulf War as well as the winding down of the Cold War have brought about a shift in domestic and regional opinion concerning what Japan can and should do abroad to support its allies. Due largely to this change in public mood, Tokyo decided in April to send MSDF minesweepers to the Persian Gulf to assist postwar cleanup of the mine-ridden area (see JEI Report No. 17B, May 3, 1991). The positive response this action received from the United States and other allies as well as from the Japanese public no doubt encouraged the administration of Prime Minister Kaifu in mid-September to put forward a revamped version of last year's failed legislation to allow Japanese personnel to participate in United Nations-backed peacekeeping operations. If enacted, the bill would authorize the dispatch overseas of as many as 2,000 lightly armed SDF members -- the first such dispatch in Japan's postwar history (see JEI Report No. 36B, September 27, 1991). Since the LDP-led government worked closely with the two centrist opposition parties, Komeito and the Democratic Socialist Party, in developing the new proposal, the peacekeeping-operations bill stands an excellent chance of passing the Diet, probably early next year.

Because this kind of action is unprecedented in Japan's postwar history, the bill's drafters had to include several provisions to ensure that SDF members would not find themselves embroiled in a conflict situation. Specifically, parties involved in U.N.-mediated disputes first must agree to a cease-fire and accept deployment of peacekeeping forces. All peacekeeping forces also must remain neutral. Perhaps the most important stipulation is that participating Japanese forces would be withdrawn if any of these conditions are not met.

Critics might argue that these stipulations, in effect, defang the proposal and are further evidence of Japan's unwillingness to put itself at risk with the rest of its allies. Yet, Tokyo insists that these provisions are necessary to dispel possible residual concerns in Japan and in the Asian Pacific about the use overseas of the Japanese military. What should not be overlooked is the dramatic turnaround in public opinion in a country where decisionmaking typically proceeds at a snail's pace. Perhaps this reflects the Japanese people's recognition that a more engaged foreign policy now is in order.

Conclusion

The demise of the Cold War order has presented Japan with an opportunity to reevaluate the nature and the extent of its self-defense mission. This reassessment will be conducted in a gradual manner since the global context continues to change. As a result, the current five-year defense program will not be altered dramatically through FY 1993; slight adjustments may be made, depending on international and regional developments, during the following two years. These modifications may alter previous plans to purchase sophisticated weapons systems from the United States; that, in turn, could become a bilateral irritant.

If the U.N.-peacekeeping bill passes, it could open the door to greater foreign policy activism on Tokyo's part. The initial focus may be the Asian Pacific region, where the Japanese government has indicated it is interested in facilitating a peaceful resolution of the conflict in Cambodia. Moves to develop Japan's defense industry will be weighed against the external concerns of Japan's allies and the internal concerns of a people that for the past 46 years have embraced a pacificist philosophy on foreign policy.

For further information, contact Barbara Wanner.

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JEI

REPORT

A Two-Part Report: A and B

NO. 38B
October 11, 1991

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Kaifu Withdraws From LDP Leadership Race

Political developments in Tokyo in the latter part of September and the early days of October have given an entirely new meaning to the word "unpredictable." Prime Minister Toshiki Kaifu, previously expected by many political analysts to win reelection to the ruling Liberal Democratic Party presidency and the premiership when his party term expires October 30, announced October 4 that he would not seek the ruling party's top leadership position. Mr. Kaifu's abrupt decision to withdraw from the race followed the scrapping three days earlier of a cabinet-approved package of bills that would have reformed Japan's political system. The prime minister repeatedly had declared that he would stake his political life on this legislation.

Although only one factor in his downfall, Mr. Kaifu's handling of the decision by LDP influentials to pull the political reform package undercut much of his already tenuous support within the LDP. Mr. Kaifu, whose corruption-free background had attracted the attention of LDP doyens more than two years ago, had been tapped by faction leaders to help rectify the party's tainted image in the wake of the Recruit Co., Ltd. influence-peddling scandal. Ironically, the prime minister appears to have been undone by precisely the behind-closed-doors wheeling and dealing that many Japanese associate with the style of politics that gave rise to the Recruit affair.

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In an October 5 press conference Mr. Kaifu declined to go into specifics about his decision to step down at the end of October as LDP president and prime minister, saying instead that he was compelled to do so by his commitment to reforming Japan's political system. "Clarifying responsibility is an important part of political reform," he said. The prime minister emphasized that his successor should continue this effort. "The fire of political reform must never be extinguished [and] I hope the new leader will carry out [these changes]," Mr. Kaifu said.

During the special Diet session, which ended October 4, the prime minister had been pushing for enactment of three bills that would have redrawn electoral districts for the Diet's lower house and revised campaign financing laws. Perhaps the most controversial provision would have reduced the number of seats in the House of Representatives from 512 to 471. Of this reduced number of members, 300 were to be elected from single-seat constituencies, with the other 171 elected according to proportional representation. (Under the current multiseat system three to five representatives are elected from each of the 130 electoral districts.)

Although the political reform proposals were approved in late June by the LDP Executive Council and, subsequently, the cabinet, the ruling party was not united fully behind the proposed changes. An alleged "silent majority" of LDP members objected to the plan because a switch to a single-seat system would mean that some representatives either would lose their constituencies or would be forced to run in different districts. A significant number of LDP members also questioned whether a single-seat system would bring an end to the exorbitantly expensive political campaigns that have been characteristic of the multiseat system (see JEI Report No. 25B, July 5, 1991). The opposition parties, which more likely would incur the most losses in single-seat contests, opposed the reforms outright.

Typical of the arcane world of Japanese politics, where considerable negotiating and dealmaking occurs behind closed doors, it appears that the October 1 decision by the lower house's special committee on political reform to kill the political reform legislation was motivated as much by substantive disagreements as by some legislators' desires to change the LDP leadership. Unlike most previous prime ministers, Mr. Kaifu is not a faction head. Due to his lack of a strong political base, the prime minister has been dependent on the support and general good graces of Shin Kanemaru, head of the largest LDP faction that bears the name of ex-Prime Minister Noboru Takeshita. This dependency has been so strong, in fact, that critics labeled the Kaifu administration a Kanemaru/Takeshita puppet government. But even with these ties, Mr. Kaifu has appeared at times vulnerable to an ouster due, in part, to his cautious, deliberative -- some might say indecisive -- leadership style and the maneuvering of would-be successors, who may not have been supportive of many of his initiatives.

Despite Mr. Kaifu's tenuous hold on the LDP presidency, some analysts were saying as recently as late August that he stood a good chance of winning reelection because of his strong public popularity as well as the political opportunities created by Japan's brokerage and banking scandals (see JEI Report No. 32B, August 23, 1991). While no politicians have been linked directly to these scandals, political commentators suggested at the time that the public, sensitized by news reports of questionable behavior in financial matters, would oppose prime ministerial contenders -- such as former Finance Minister Kiichi Miyazawa and ex-Prime Minister Takeshita -- who were forced to resign their posts more than two years ago due to the nature and the extent of their involvement with Recruit.

By the end of the first week of September, however, Mr. Kaifu's political prospects took a turn for the worse. Perhaps fed up with living in the shadow of the Recruit affair -- and viewing Mr. Kaifu as a "seat warmer" prime minister -- Mr. Miyazawa announced September 7 that he would challenge the incumbent for the LDP presidency. The same day in Washington former Prime Minister Yasuhiro Nakasone at a conference sponsored by the Center for Strategic and International Studies and the Japan-America Society indirectly referred to Mr. Kaifu in a speech as a "relief pitcher." One week later Hiroshi Mitsuzuka and Michio Watanabe, the heads of the second- and the fourth-largest LDP factions, respectively, indicated that they had agreed on "the need to change the country's political stream."

By the end of September political reform was dead. This does not appear to be a coincidence. While no one in the U.S. or Japanese governments is willing to speculate, Mr. Miyazawa and other senior LDP officials critical of Mr. Kaifu's leadership certainly have the clout -- and may have affected the special Diet committee's decision -- to kill the political reform package; this tactic was viewed as a means of forcing the prime minister out of the upcoming race.

Mr. Kaifu's ultimate undoing, however, may have been the way in which he handled this overt challenge to his leadership. On learning of the special committee's decision, the prime minister angrily said that this had given him the "firm determination" to carry out political reform. In a country renowned for the indirect manner in which people sometimes prefer to communicate, this phrase was understood as Mr. Kaifu's intent to dissolve the Diet and call for national elections so that voters could express their views on changing Japan's political system via their ballots. The prime minister's implied threat received round criticism from members of the ruling party, although some reports maintain that Mr. Kaifu made his uncharacteristically blunt statement with the approval of his political benefactor, Mr. Kanemaru. What may have cost the prime minister the support of the Takeshita faction was his apparent unwillingness to follow through on the implied threat to dissolve the Diet.

Another factor seemingly shaped this outcome as well. In a bow to the prime minister's plea for continued work on political reform, the secretaries general of the ruling and the opposition parties had convened to discuss setting up an interparty advisory panel to examine the issue. Mr. Kaifu, however, insisted that the group come under the jurisdiction of the speaker of the Diet's lower house -- controlled by the LDP -- and that it submit a report on proposed reforms before the regular session of the Diet convenes in January. When the five parties represented at the meeting rejected these proposals categorically in favor of an unofficial status for the group and a longer time frame for its study, Mr. Kanemaru apparently felt that a new LDP head was needed.

Messrs. Miyazawa, Mitsuzuka and Watanabe formally declared their candidacies for the LDP presidency October 5. Some press reports contend that Mr. Miyazawa -- who previously has held cabinet posts considered prerequisites for the prime ministership, that is, Finance and Foreign Affairs -- currently is the front-runner, but he cannot expect to clinch the top leadership position without the backing of the 106-member Takeshita faction (see Table).

Liberal Democratic Party Factions, October 1991

(Diet upper and lower house membership)

Noboru Takeshita	106
Hiroshi Mitsuzuka	89
Kiichi Miyazawa	82
Michio Watanabe	70
Toshio Komoto	31
Independents	14
Total	392

At JEI press time Mr. Kanemaru had not indicated whether his group would field its own candidate or back one of the existing contenders. Some analysts have suggested that the Takeshita faction may be holding off to strengthen its leverage over the field; others contend that former LDP secretary general Ichiro Ozawa, Mr. Kanemaru's protege, may be approached to run. The up-and-coming member of the Takeshita faction, however, lacks Mr. Miyazawa's diplomatic and international financial experience; moreover, he was hospitalized earlier this year with heart problems. Former Agriculture Minister Tsutomu Hata also has been mentioned as a possible Takeshita faction-sponsored candidate, although as chairman of the LDP's Research Commission on the Election System, he may be perceived as favoring timely action on political reform.

The election for LDP president has been set for October 27. The winner of this race, in turn, will be elected prime minister shortly after because of the LDP's majority in the lower house. According to the Japanese constitution, the decision of the Diet's lower house in selecting the nation's leader, if different from that of the upper house (controlled by the opposition parties), always will prevail.

Barbara Wanner

Special Diet Session Adjourns

Although Prime Minister Toshiki Kaifu's priorities for this year's special legislative session were passage of a package of political reform bills and a measure that would allow lightly armed military personnel to join United Nations-sponsored peacekeeping operations, the Diet adjourned October 4 with neither enacted. The political reform legislation was killed (see preceding article). Along with a separate measure to allow Self-Defense Forces members to engage in overseas disaster relief missions, the U.N. peacekeeping operations bill was tabled for further consideration in the regular Diet session, scheduled to convene in January.

Many Japanese experts remain convinced, however, that a discount rate cut is on the way. One scenario calls for the cut to come soon after BOJ governor Yasushi Mieno returns from a mid-October meeting of financial leaders from the Group of Seven industrial democracies in Bangkok, Thailand. That meeting coincides with a World Bank/International Monetary Fund meeting that starts October 13.

In addition to being consistent with other recent monetary measures taken in Japan, the change in the reserve requirement fits into a long-run pattern. The Bank of Japan continues to play the role of free-market economics instructor to its sometimes reluctant pupils in the banking community. The ways in which BOJ has moved to change its intervention instruments (see JEI Report No. 42B, November 4, 1988) and to eliminate window guidance (see JEI Report No. 27B, July 19, 1991), combined with the reserve requirement change (ahead of or in place of dropping the discount rate), suggest that the Japanese central bank continues to refashion its monetary policy into a form that more closely resembles that of the United States and other industrial countries. Instead of direct intervention in bank activities through lending or administrative guidance, BOJ clearly is signaling the financial community that it prefers to operate through market mechanisms. Some observers, accustomed to having the central bank overwhelm financial institutions with its straightforward fastball deliveries, have characterized BOJ's new approach as a reach for a curveball.

The move on reserve requirements reflects BOJ's market-oriented philosophy in three ways. By avoiding (for now) a discount rate cut in favor of changes in reserves, the central bank has chosen the more hands-off alternative. Moreover, in lowering reserve requirements, it lifts what amounts to a regulatory burden on banks. The sharp cut and resultant low level of reserves suggest that further reductions are unlikely soon, given concerns about the safety and the soundness of the banking system. To the extent that BOJ minimizes its future use of discount rate adjustments and reserve requirement changes, it is left primarily with the mainstay of U.S. monetary policy -- open market operations that work in a nondiscriminatory fashion through credit markets. Coming months will demonstrate how well Japanese banks like the new pitching style.

Douglas Ostrom

United States Nudges Japan From Ranking As World's Top Aid Donor

In 1990 the United States regained its position as the largest donor of foreign aid among the 18 nations making up the Organization for Economic Cooperation and Development's Development Assistance Committee, the Paris-based organization announced October 1. Questions over whether certain types of debt forgiveness should be included in DAC members' accounts of aid disbursements complicated the most recent OECD effort to compare economic assistance programs and delayed this year's release of the preliminary figures three months beyond the usual date.

Central to this debate is the question of whether the United States should be able to report as economic assistance $1.2 billion of military debt forgiveness for Egypt. This represents the 1990 portion of a nearly $7 billion military debt Washington decided last year to cancel in return for Egypt's support in the Persian Gulf War. DAC Statistical Reporting Directives allow members under certain conditions to report as official development assistance the forgiveness of some non-ODA debt. In preliminary discussions of how to record debt forgiveness DAC members concurred that military aid should not be included in DAC economic assistance statistics, but they were divided over how to treat forgiveness of military debt and other non-ODA debt.

OECD reported that some donors, presumably including the United States, contended that military debt forgiveness is not equivalent to military aid and can have an economic effect equivalent to that of other forms of debt relief. Japan reportedly was foremost among the members that asserted that including forgiveness of military debt in ODA figures is inappropriate. The OECD report said that certain members pointed to problems with counting such debt forgiveness as aid, "particularly in a situation where developing countries are encouraged by donors to reduce military expenditures and arms imports, and also because of the possible adverse effect on public opinion." Moreover, Tokyo, which prohibits weapons exports to all but the United States, this spring announced new guidelines for foreign aid that include taking into consideration whether a recipient nation is developing or manufacturing weapons of mass destruction (see JEI Report No. 16B, April 26, 1991).

Another aspect of the debate is whether to include forgiveness of export credit claims in DAC members' economic assistance records. Japan reported $15 million of this form of non-ODA debt relief last year. DAC agreed to review the issue of what to record as debt forgiveness, taking a close look at military debt and export credits. OECD included the non-ODA debt forgiveness reported by certain members in their individual records but omitted the amounts from total DAC aid pending the committee's review of the issue. Excluding the military debt forgiveness figure would not change America's number-one ranking among DAC donors, but observers note that inclusion of this type of non-ODA debt relief could affect future rankings.

Currency fluctuations and the timing of contributions to multilateral organizations often play into comparisons of DAC members' foreign aid programs. That was the case in 1989 when a significant drop in net disbursements of U.S. official development assistance precipitated America's loss of its longtime standing as the world's top aid donor. Japan then moved into the number-one position, which it had been close to attaining for several years. Last year U.S. foreign aid jumped 48.1 percent, bringing this country's net disbursements of economic assistance to $11.4 billion (see Table 1). Japan returned to the number-two position among DAC donors, with outlays of just over $9 billion for economic assistance.

Japan's net disbursements last year rose 6.2 percent in yen terms and 1.2 percent in dollar terms from 1989's level. After adjustments for changes in prices and the yen-dollar exchange rate, Japan's total ODA disbursements increased more than 4 percent in 1990. Bilateral assistance increased 3 percent in real terms while multilateral contributions rose 8 percent. More than half of Japan's bilateral aid consisted of loans, which increased by an adjusted 4 percent in 1990, the OECD reported. Grants rose 3 percent.

Overall DAC net disbursements to developing countries and multilateral institutions reached $54.1 billion in 1990, up 15.7 percent in nominal terms

Table 1: ODA of Major Donor Countries, 1986-90

(in millions of dollars; net disbursements)

1990 Rank	Country	1986	1987	1988	1989	1990*	Share of Total DAC ODA 1990*
1	United States	$9,564	$8,945	$10,141	$7,676	$11,366	21.0%
2	Japan	5,634	7,342	9,134	8,965	9,069	16.8
3	France**	3,403	4,489	4,777	5,162	6,571	12.2
4	Germany	3,832	4,391	4,731	4,948	6,320	11.7
5	Italy	2,404	2,615	3,193	3,613	3,395	6.3
6	United Kingdom	1,737	1,871	2,645	2,598	2,647	4.9
7	Canada	1,695	1,885	2,347	2,320	2,470	4.6
DAC Total***		36,663	41,426	48,132	46,723	54,077	100.0

*Preliminary.
**Excluding overseas departments and territories.
***1990 total includes France's overseas departments and territories but does not include disputed amounts.

Source: Organization for Economic Cooperation and Development

Table 2: ODA as Percentage of GNP for DAC Countries, 1986-90

(in millions of dollars; net disbursements)

1990 Rank		1986		1987		1988		1989		1990*		Percent Change 1989-90*
		Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	
1	Norway	$798	1.20%	$890	1.09%	$985	1.13%	$917	1.05%	$1,207	1.17%	31.5%
2	Netherlands	1,740	1.01	2,094	0.98	2,231	0.98	2,094	0.94	2,592	0.94	23.8
3	Denmark	695	0.89	859	0.88	922	0.89	937	0.93	1,171	0.93	25.0
4	Sweden	1,090	0.85	1,375	0.88	1,534	0.86	1,799	0.96	2,012	0.90	11.8
5	Finland	313	0.45	433	0.49	608	0.59	706	0.63	846	0.64	19.8
6	France**	3,403	0.48	4,489	0.51	4,777	0.50	5,162	0.54	6,571	0.55	27.3
7	Belgium	547	0.48	687	0.48	618	0.39	703	0.46	891	0.45	26.6
8	Canada	1,695	0.48	1,885	0.47	2,347	0.50	2,320	0.44	2,470	0.44	6.5
9	Germany	3,832	0.43	4,391	0.39	4,731	0.39	4,948	0.41	6,320	0.42	27.7
10	Australia	752	0.47	627	0.34	1,101	0.46	1,020	0.38	955	0.34	-6.3
11	Italy	2,404	0.40	2,615	0.35	3,193	0.39	3,613	0.42	3,395	0.32	-6.0
12	Japan	5,634	0.29	7,342	0.31	9,134	0.32	8,965	0.31	9,069	0.31	1.2
13	Switzerland	422	0.30	547	0.31	617	0.32	558	0.30	750	0.31	34.5
14	United Kingdom	1,737	0.31	1,871	0.28	2,645	0.32	2,598	0.31	2,647	0.27	1.9
15	Austria	198	0.21	201	0.17	301	0.24	282	0.23	389	0.25	37.7
16	New Zealand	75	0.30	87	0.26	104	0.27	87	0.22	93	0.22	6.7
17	United States	9,564	0.23	8,945	0.20	10,141	0.21	7,676	0.15	11,366	0.21	48.1
18	Ireland	62	0.28	51	0.19	57	0.20	49	0.17	57	0.16	16.3
DAC Total***		36,663	0.35	41,426	0.34	48,132	0.36	46,723	0.34	54,077	0.35	15.7

*Preliminary.
**Excluding overseas departments and territories.
***1990 Total includes France's overseas departments and territories, but does not include disputed amounts.

Source: Organization for Economic Cooperation and Development and 4 percent in real terms. OECD officials attributed the rise to significant increases in foreign aid by several countries, including the United States, Japan and France. Had France's disbursements to its overseas departments and territories been included, that country's net ODA disbursements would have been nearly $9.4 billion, elevating it to the number-two donor spot, instead of the number three.

Economic assistance as a percentage of gross national product for DAC members' combined totals rose only slightly from 0.34 percent in 1989 to 0.35 percent last year, an improvement the OECD report said reflected in part the expected recovery from 1989's markedly low level (see Table 2). As in previous years, the highest ODA/GNP ratios were achieved by Norway, the Netherlands, Denmark and Sweden. At 0.31 percent, Japan's 1990 GNP/ODA ratio remained unchanged, as did its 12th-place ranking on this scale among DAC members. The U.S. ratio rose to 0.21 from 0.15 in 1989; only Ireland gave a smaller share of GNP.

Moving Japan's ODA/GNP ratio closer to the DAC average is one goal of the fourth medium-term foreign aid program announced by the Japanese government in June 1988. Foreign Minister Taro Nakayama expanded upon that objective this past June by urging the government to consider boosting the ratio to 1 percent within five years. Another target announced in Tokyo's 1988 plan is to increase the aggregate amount of economic assistance disbursed over the 1988-92 period to more than $50 billion. ODA disbursements in the first three years of the plan totaled $27.3 billion. The Ministry of Foreign Affairs has indicated that its request for a 9.8 percent increase in foreign aid spending during FY 1992 should enable Tokyo to meet the five-year pledge.

Economic assistance plans for Eastern Europe as well as the Soviet Union are expected to have an impact on the 1991 DAC figures. Preliminary OECD data on DAC efforts to provide official development aid for Eastern Europe show Japan among the large donors to the region in 1990, reporting disbursements of $153 million. DAC members' contributions to Eastern Europe, which totaled about $1.5 billion last year, do not suggest a significant diversion of ODA from developing countries, OECD noted.

The latest OECD assessment of foreign aid trends reflects expanding demands on donor countries' resources. The assessment also underscores the political nature of the various forms of economic assistance, which has implications for future definitions of foreign aid.

Margo Grimm

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REPORT

A Two-Part Report: A and B

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JAPAN AND THE NORTH AMERICAN FREE TRADE AGREEMENT

Negotiators from the United States, Canada and Mexico initiated discussions this past June to hammer out a North American Free Trade Agreement that would link more closely the three economies. Although only recently proposed, the plan to bring Mexico into the existing free trade agreement with Canada already has become a source of conflict and concern in many circles.

Among the key worries in Washington is that third countries will benefit from the pact without making the concessions required of the signatories. This issue has focused attention on Japan, a particular target of fears that nonparticipants will use Mexico as a platform from which to ship products duty-free into the United States and Canada. The Bush administration, while pointing to the advantages of any foreign investment in Mexico, has pledged to seek strong rules of origin to ensure that third-country manufacturers operating in Mexico incorporate substantial North American content into the products they send to the United States and Canada.

Mexico City, which has ambitious goals for increasing foreign investment, anticipates that strengthened ties to the economies of its northern neighbors will bolster Mexico's attractiveness to foreign investors eager for expanded access to the North American market. Yet investors outside the region see NAFTA as offering risks as well as opportunities. Japanese investment in Mexico grew quickly in the 1980s, but Japanese businesses have not completely overcome their cautiousness about Mexico's investment climate. With the prospect of NAFTA producing changes, Japanese interests are likely to weigh carefully the new opportunities and the constraints involved in increasing their presence in Mexico.

While expanded international competitiveness is a benefit held out to NAFTA participants, many business and government leaders outside North America are wary of the worldwide trend toward trade blocs, which can place economies excluded from membership at a competitive disadvantage. The potential side effects of NAFTA loom particularly large in Japan since the United States is its dominant overseas market and supplier. NAFTA will strengthen economic ties between the United States and its biggest and third-largest trading partners, possibly to the detriment of Japan, number two in two-way U.S. trade.

Background

The impetus for a free trade agreement between Mexico and the United States stems in part from developments outside North America. Not only is the European Community moving toward formal integration of the economies of its member nations but capital from European investors is expected to be channeled toward supporting the development of Eastern Europe. Japan's rapidly intensifying economic ties in the Pacific Basin also have led some American policymakers and analysts to speculate that an Asian trade alliance may become a reality. Meanwhile, the stalemate in the latest round of multilateral trade negotiations under the General Agreement on Tariffs and Trade threatens to undermine confidence in global solutions to international trade liberalization (see JEI Report No. 37B, October 4, 1991). Washington observers note that growing pessimism about the prospects of a successful conclusion to the Uruguay Round has prompted the Bush administration to pursue other options for liberalizing trade.

Against this background Mexican President Carlos Salinas de Gortari and President Bush met in June 1990 to consider expanding economic relations between the two countries and agreed to pursue a comprehensive bilateral trade agreement. The action by President Salinas represented a reversal of Mexico City's previous position, which had been that a free trade pact between the two diverse economies was unworkable. The proposal also marked another upturn in previously troubled bilateral economic relations. Mexico City's efforts since the mid-1980s to implement significant trade and investment reforms already had gone far to ease tensions over what Washington long had criticized as interventionist economic policies marked by excessive restrictions on foreign goods, services and investment.

Canada, which signed a free trade agreement with the United States that took effect January 1, 1989, asked to participate in the U.S.-Mexico talks. In June 1991 representatives from all three nations met in Toronto to launch negotiations for a North American Free Trade Agreement.

NAFTA's quick progression from the proposal stage to initial negotiations encountered some turbulence. In the United States the process was marked by intense public debate, described by one Bush administration official as

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unusual so early in a round of trade negotiations.[1] The proposed pact came into the spotlight early on as the Bush administration asked Congress to extend special procedures for congressional consideration of international trade pacts; this authority was seen as crucial for initiating the talks with Mexico. Many on Capitol Hill, some already critical of the White House's handling of trade policy issues, were wary of the anticipated agreement and anxious that the executive branch not overlook a number of problems lawmakers felt could arise from such an arrangement (see JEI Report No. 20B, May 24, 1991).

Most NAFTA discussion on Capitol Hill has focused on how the proposed agreement would affect American jobs, particularly in the automotive, steel and electronics sectors. Lawmakers have argued that lower wage rates and less-stringent environmental standards will draw American companies south. Moreover, imports from Mexico will have a negative effect in such areas as agricultural produce and apparel, these legislators say. A closely related worry has been that third countries will take advantage of Mexico's improved access to the U.S. market by using that country as a transshipment point or as a processing base for their products. From the U.S. perspective it is this concern that has linked Japan with the NAFTA discussions. Japan joins Taiwan and South Korea as the most likely third-party countries to use Mexico as a base for expanded sales to the United States and Canada. Although the role of such third countries has not been a central issue in the NAFTA debate, Washington observers note that it has had a "shadow effect" on the discussions.

Supporting Arguments from the White House and Other Advocates

The Bush administration offers a broad-based explanation of its interest in pursuing a North American Free Trade Agreement. At the Department of State counselor Robert Zoellick portrays NAFTA as "a rare opportunity to secure, strengthen, and develop our continental base economically and politically in a way that will promote America's foreign policy agenda, our economic strength and leadership, and U.S. global influence."[2] But despite this multifaceted rationale for NAFTA, advocates of the pact give center stage to the economic benefits that the arrangement could bring by creating the world's largest market -- 360 million consumers and an annual output totaling $6 trillion. The Office of the U.S. Trade Representative, for example, emphasizes the opportunities for economic growth and global competitiveness offered by regional free trade.

The emphasis on NAFTA's economic benefits reflects, in part, concerns about the significant U.S. trade shortfall with Japan and growing worries here about waning U.S. international competitiveness. Backers of NAFTA, including the Bush administration, assert that the agreement will boost the competitiveness of its participants and serve to counterbalance Japan's close economic ties to Asian Pacific countries and the strengthening EC trade bloc.

[1] Speech by Mollie Van Heuven, director, Office of Private-Sector Liaison, Office of United States Trade Representative, to Women in Government Relations, Washington, D.C., September 26, 1991.

[2] Written statement of Robert Zoellick before the Senate Committee on Foreign Relations, April 11, 1991, p. 1.

NAFTA also has been portrayed as a means of mimicking patterns believed to have contributed to Japan's economic success. The same day he and President Bush formally announced their intention to pursue a comprehensive bilateral trade agreement President Salinas noted, "The complementarity of our two economies is of strategic importance. Japan's success has been owed in part to its incorporation of its neighbors into production processes in a way that goes beyond mere trade relations. . . . [A] free trade agreement between our countries could be the answer to this extraordinary challenge."[3] The Bush administration has made the same point. In April Mr. Zoellick of the State Department told the Senate Committee on Foreign Relations, "Japanese firms increase their competitiveness and keep high-paying jobs by sourcing components in Asia. . . . A North American Free Trade Agreement is likely to channel any additional shifts of lower wage, low value-added, often assembly jobs to locations in Mexico that would be integrated with higher wage U.S. manufacturing operations."[4] Underlying this comparison is the argument that keeping low-wage jobs in this country will not help the United States compete against the high wages and sophisticated technologies of such economies as Japan's.

Once NAFTA is in effect, its supporters say, U.S. manufacturers struggling to stay competitive will not be as compelled to move their operations offshore to low-wage regions like East Asia, taking with them administrative purchasing and warehousing jobs that could have been based in this country. Mr. Zoellick and others point out, "If these jobs leave the continent, they are likely to end up in locations that feed into Japanese or other nations' high-wage manufacturing operations. By increasing efficiency and lowering the cost of inputs, higher value and higher wage U.S. manufacturing operations are likely to be better positioned to take on competition from Europe and Asia."[5] NAFTA advocates also suggest that the agreement could draw more Japanese investment into the United States, where highly skilled workers could produce components for assembly into final products in Mexico.

U.S. manufacturers, however, worry that the low cost of labor in Mexico would attract third-country producers as well as American and Canadian investors. In conjunction with the advantages of lower or no tariffs on U.S.-Mexico trade and the reduction or elimination of other barriers to cross-border transactions expected under NAFTA, this is a comparative benefit many American interests are loath to dilute by sharing it with suppliers outside the pact.

The Bush administration, in line with its philosophy that market forces should determine international direct investment flows, backs expanded access by all foreign investors to Mexico. Supporters argue that any foreign investment in Mexico will benefit the United States in the long run by spurring economic growth there and creating jobs that will ease emigration pressures.

[3] Speech by President Carlos Salinas de Gortari to the Business Roundtable, Washington, D.C., June 11, 1990, cited in U.S. International Trade Commission, Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexico Relations (USITC Publication 2326) (Washington, D.C.: October 1990), p. I-13.

[4] Zoellick, op. cit., pp. 6-7.

[5] Zoellick, op. cit., p. 7.

Moreover, advocates assert that geography will work in favor of the United States and that third-country investors will turn to American suppliers for components.

Conflicting Analyses and Major Concerns

Numerous studies have yielded little consensus on the impact NAFTA will have on employment, trade or investment in North America. Rep. Jim Kolbe (R, Ariz.), who strongly supports NAFTA, exclaimed that so many studies on the issue abound "You can get a study to show whatever you want."[6] The White House and other supporters of the agreement often point to the findings of an International Trade Commission report issued in February 1991. The House Committee on Ways and Means and the Senate Committee on Finance last September asked the ITC to examine the likely impact on the United States of what at that time was a proposed free trade agreement with Mexico. Among the conclusions of the resulting report was that a FTA with Mexico would provide net economic benefits to this country, but that in the near to medium term the benefits would be small compared to the size of the U.S. economy. The report added that these benefits probably would increase over time.

The ITC study also concluded that a FTA could cause some cross-border shifts in employment and could affect wage rates and the level of immigration from Mexico but probably would have little or no impact on employment levels in the United States. Similarly, the study found that a bilateral trade pact could have moderate to significant effects on U.S. trade with Mexico in several of the industries examined in the study, but that because the anticipated gains or losses in bilateral trade would represent a very small part of their domestic production the changes "would likely have a negligible impact on production levels in most of the U.S. industries, both overall and regionally."[7] The industries that would be affected most adversely by a free trade agreement with Mexico would be fruits and vegetables, the study found.

Addressing concerns that third countries could circumvent U.S. tariffs and other barriers to imports by transshipping their goods through Mexico or by using Mexico as a processing and export base, the ITC report concluded, "The nature and enforcement of the rules of origin in the agreement will determine the degree to which third countries will be able to access the U.S. market by these means."[8] FTA rules of origin are intended in large part to limit preferential tariff treatment to products that are the result of significant economic activity in the free trade region. The rules of origin included in the U.S.-Canada FTA outline a specific set of criteria for determining the country origin of goods; prior to the bilateral agreement American trade regulations did not specify the means for deciding the origin of imports.

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[6] Speech by Rep. Jim Kolbe to Women in Government Relations, Washington, D.C., September 26, 1991.

[7] International Trade Commission, The Likely Impact on the United States of a Free Trade Agreement with Mexico (USITC Publication 2353) (Washington, D.C.: February 1991), p. xi.

[8] *Ibid.*, p. viii.

Some Washington influentials are dissatisfied with existing assessments of the possible impact of a trade agreement that includes Mexico. The executive branch, noting that it would benefit from another look at the economic implications of a pact including Mexico, in early August asked the ITC to produce a study on the question based largely on recent nongovernment economic research on NAFTA. Most arguments that the proposed pact needs further study stem from Congress, which signaled its intent to play a greater role in trade negotiations during the debate this spring over whether to grant the administration's request for a two-year extension of fast-track procedures for congressional consideration of multilateral trade agreements.

House Majority Leader Richard Gephardt (D, Mo.) has spearheaded efforts to accumulate further information and analysis to aid lawmakers' assessments of the possible effects of the NAFTA negotiations. Skeptical of the predictions made by the executive branch, Rep. Gephardt and many of his colleagues have requested additional studies on NAFTA-related issues from sources outside the administration (see JEI Report No. 33B, August 30, 1991).

At Rep. Gephardt's instigation, House Ways and Means Committee chairman Dan Rostenkowski (D, Ill.) asked the ITC to conduct an analysis of several different rules of origin standards that might be used in NAFTA. In a late August letter to acting ITC chairman Anne Brunsdale, Rep. Rostenkowski indicated that lawmakers are particularly interested in the impact various rules of origin proposals would have on the North American automotive industry. Underscoring a concern voiced by many on Capitol Hill, he noted that "any origin standard for automobiles under the NAFTA should inure to the benefit of the parties to the agreement and should not invite only minimal processing or investment in order to qualify for preferential treatment."[9]

Many lawmakers seized on the importance of rules of origin to the U.S. automotive industry after Honda Motor Co., Ltd.'s U.S. subsidiary was accused in June of circumventing duties on Civics brought into the United States from its Canadian plant; Honda allegedly had overstated the North American content of the vehicles to obtain duty-free entry (see JEI Report No. 32A, August 23, 1991). Cars and trucks are among the products that must meet a North American content requirement to qualify for preferential tariff treatment under the U.S.-Canada FTA; the rule is intended to direct the benefits of the pact to the participants by limiting the third-country content of products in cross-border trade.

Most observers expect Congress will insist on a North American Free Trade Agreement that includes tough rules of origin. Rep. Rostenkowski noted, "One of the most important and controversial issues in these negotiations will be provision of adequate rules of origin to determine the eligibility of products for duty-free and other preferential treatment under the agreement. The Congress will closely scrutinize these rules to ensure that they are in the best interests of U.S. industries and workers."[10] Some on Capitol Hill also have expressed concern that adequate mechanisms be written into the agreement to ensure compliance with these rules.

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[9] Letter from Rep. Dan Rostenkowski to Anne Brunsdale, acting chairma International Trade Commission, August 27, 1991.

[10] _Ibid._

Washington observers note that the lawmakers most apprehensive about Japan taking advantage of NAFTA are those allied to labor or to industries that must compete with Japanese-made products -- for example, motor vehicles, steel and electronics -- as well as those who in principle are wary of the agreement. In many cases legislators' concerns about an expanded Japanese presence in Mexico are an extension of their qualms about Japanese business practices and government policies.

Maquiladora Issue - Many congressional anxieties about Japan and other third countries taking advantage of NAFTA echo those voiced about Japanese investment in maquiladoras, assembly plants located in Mexico, largely near the U.S. border, that benefit from special American and Mexican customs treatment. Duties on products assembled in maquiladoras from American-made parts and returned to the United States are levied only on the value added in Mexico. Sales of maquiladora-assembled goods in the Mexican market currently are limited.

Japanese companies represent only a small fraction of the businesses currently operating maquiladoras, but some critics argue that Japanese manufacturers can use the program to bypass U.S. import quotas and other trade restrictions and to target more easily the American market. Some observers note that the speed with which Japanese firms availed themselves of the maquiladora program has important implications for the Japanese response to NAFTA. Japanese investment in maquiladoras rose from eight plants in 1980 to 70 within 10 years.[11] During this period the ranks of maquiladoras grew from 620 to nearly 2,000, mostly American-owned. The Japanese maquiladoras include a large number operated by electronics companies.

The February ITC study noted that the difference between maquiladoras and other production facilities in Mexico may erode under NAFTA; many of these plants, it added, may grow beyond assembly operations to become integrated foreign-owned manufacturing plants.[12] Mexico City has proposed that the existing status of the maquiladora program be retained under NAFTA. If continued in its current form, the very successful program could offer trade benefits not available to other facilities until, or even after, the provisions of NAFTA are implemented fully. However, many issues affecting maquiladoras remain to be decided.

Mexico's secretary of commerce and industrial development, Jaime Serra Puche, in early September emphasized that the nationality of maquiladora operators would not be an issue under the proposed NAFTA, although the content of inputs in maquiladora production would be discussed. Gabriel Szekely, a senior research fellow at the Center for U.S.-Mexican Studies at the University of California, San Diego, notes that from Mexico's perspective the maquiladora program long has exemplified a free trade arrangement. Existing Mexican law

[11] Gabriel Szekely, "In Search of Globalization: Japanese Manufacturing in Mexico and the United States," in Gabriel Szekely (ed.), Manufacturing Across Borders and Oceans: Japan, the United States, and Mexico (Monograph Series, 36) (La Jolla, California: Center for U.S.-Mexican Studies, University of California, San Diego, 1991), p. 121.

[12] USITC, op. cit., p. V-5.

does not subject maquiladoras to any rules of origin; thus, the plants currently incorporate a very small percent of local input. If the Mexican government does concede on this issue, Mr. Szekely says, it will have to be in response to the United States or Canada; Mexico has no interest groups pressuring the government to institute rules of origin for the maquiladora program.[13] Mr. Szekely predicts that while the maquiladora program eventually may be phased out, it will be continued until it is clear that NAFTA is going to work.

Private-Sector Concerns - Capitol Hill discussions point to the U.S. automotive industry being particularly apprehensive about Japan using Mexico to increase its sales in the United States. In 1989 Mexico exported an estimated $3 billion worth of automotive products to the United States; these shipments topped exports of manufactured goods to this country in all categories except electrical equipment. Five firms dominate car production in Mexico: the American Big Three -- General Motors Corp., Ford Motor Co. and Chrysler Corp. -- plus Nissan Motor Co., Ltd. and Volkswagen AG. The Big Three run maquiladora plants that complement their other production facilities in Mexico; Nissan does not have a maquiladora operation. Several hundred companies currently manufacture automotive parts there.

The February ITC study concluded that a trade agreement including Mexico would have an uncertain effect on the U.S. automotive industry; the most significant impact could result from the liberalization of existing Mexican restrictions on trade and investment in that sector. These include requirements that motor vehicle manufacturers maintain a trade surplus with Mexico and that both automotive manufacturers and their parts suppliers have at least 36 percent Mexican content. The study noted that were a FTA to include Mexico, the result "likely would encourage the Big Three to restructure their Mexican operations to increase their specialization, thereby achieving economies of scale and, in turn, enhancing their competitive position vis-a-vis Asian and European producers."[14]

The ITC analysis also pointed out that the investment plans of third-country firms not currently manufacturing automotive products in Mexico, particularly Japanese producers, also would factor into a trade agreement's impact on the industry. The incentive for these manufacturers to produce in Mexico "would largely hinge on whether or not they would be excluded from the benefits of a FTA, such as the removal of Mexican investment restrictions and performance requirements," the study concluded.[15]

In early September the Big Three took steps to secure their investment position in Mexico. Arguing that for several years they have worked under restrictive conditions imposed by the Mexican government, the vehicle manufacturers urged the Bush administration to negotiate preferential treatment for the five companies that, as of the beginning of this year, were the "major assemblers" of cars and light trucks in Mexico. In a letter to U.S. Trade Representative Carla Hills, Detroit recommended that local content requirements, duties

[13] Telephone interview with Gabriel Szekely, senior research fellow, Center for U.S.-Mexican Studies, University of California, San Diego, October 8, 1991.

[14] USITC, op. cit., p. xiii.

[15] USITC, op. cit., p. IV-21.

and other restrictions be phased out more quickly over a 15-year period for the five firms currently manufacturing in Mexico than for new investors. It also urged U.S. trade negotiators to "make clear to Mexico that a NAFTA agreement cannot allow Mexico to establish itself as a platform for major new automotive capacity from third country producers for export to the U.S. market."[16]

All three U.S. auto manufacturers recommended a higher regional content provision for duty-free cross-border transactions; Chrysler and Ford advocated 70 percent, while GM sought 60 percent. The firms concurred that NAFTA should establish separate, value-based automotive rules of origin, similar to the rules that apply under the U.S.-Canada FTA They further stressed that the automotive rules of origin "be applied in such a way to specifically prevent vehicle manufacturers and suppliers from being allowed to 'roll up' non-North American materials and value in the various stages of manufacturing and assembly." Although the term is widely debated, critics see "roll up" as a means of "sneaking" more foreign content into a product by transforming foreign materials into intermediate goods that can be qualified as domestic; these intermediate goods in turn boost the local content of the final product.

The View From Mexico and Canada

Proponents of NAFTA promise that Mexico, like the United States, will become more competitive internationally with implementation of the pact. Advocates anticipate that joint ventures and shared production arrangements will give Mexico the advantage of increased access to American product and process technologies and expertise in marketing and other areas. Moreover, they say, the domestic content requirements that apply to some industries, if relaxed, could expand the range of foreign components available to Mexican companies. Yet Mexico, facing very different economic conditions than the United States and Canada, has a unique perspective on the opportunities and the problems presented by NAFTA.

Mexico City has taken significant steps in the last five years to open its markets and to ease nearly six decades of restrictive foreign investment rules. Changes made in 1989 to Mexico's foreign investment regulations have been particularly applauded in Washington, although NAFTA proponents hope the proposed pact will give foreign investors greater access to areas such as financial services, petroleum exploration and transportation. As outlined by President Salinas, the government hopes to lift total foreign direct investment to $48 billion by the end of 1994 from 1990's level of $30 billion-plus. He and other Mexican officials have indicated their expectations that NAFTA will draw foreign investment from all sources. Speaking in Tokyo in June, the secretary of commerce and industrial development emphasized that a key objective of NAFTA is to boost competitiveness in the region and that "the way to increase competitiveness is to attract investment from other parts of the world."

There has been some concern in this country that Mexico's thirst for foreign direct investment could lead Mexican negotiators to press for low regional content rules. Trade analysts report that Mexico City hopes to avoid becoming just an assembly site for companies supplying the American and the

[16] "U.S. Automakers Press for Preferences During 15-Year NAFTA Transition," Inside U.S. Trade, September 23, 1991, p. S-3.

Canadian markets; they note that the country is trying to attract manufacturers that will incorporate a significant level of local content. Yet Mexico's severe need for capital possibly makes it less wary of third-country participation than its NAFTA partners. Mr. Szekely of the University of California notes: "From Mexico's perspective, the argument that the Japanese are using Mexico as an export platform or as a means to circumvent protectionist practices in the United States misses the point. Japanese and other foreign firms are acting as agents of economic change in Mexico, helping that country orient its economy toward world markets."[17]

In some senses Japanese investment is seen as particularly attractive to Mexico. Wilson Peres, a staff economist with the United Nations Economic Commission for Latin America and the Caribbean, points out that in seeking joint venture opportunities the Mexican government frequently has pursued foreign investment "more for its intangible assets than for its addition to the level of savings available for investment." Japanese investment offers the technology transfers and entrepreneurial skills that Mexican leaders are seeking for their country, he notes.[18]

As a result, according to Mr. Szekely, "One direction Mexico will not move -- as the United States and Canada may want -- is to discriminate against foreign investors. There will be one policy for everyone."[19] Moreover, joining a FTA could give Mexico, as well as the United States and Canada, a stronger platform from which to target such shared concerns as boosting purchases of local inputs by foreign manufacturers operating in their markets and gaining greater access to Japan's markets, Mr. Szekely contends.

Canada also has a slightly different view of how Japan might factor into NAFTA. Ottawa is less inclined to push for strict rules of origin than the United States and appears less troubled by the prospect of expanded Japanese investment in Mexico. Canada's trade minister, Michael Wilson, has said that Ottawa does not see any benefit in boosting the regional content requirement for cars and trucks beyond the 50 percent required under the U.S.-Canada free trade pact. Yet Michael Hart, director of the Center for Trade Policy and Law in Ottawa, cautions, "[T]he Canadian Auto Workers and their political supporters can be expected to use the excuse of trilateral negotiations to vent their frustration at the potential erosion of Canadian participation in North American automotive production, even though this erosion is being brought about by market forces."[20]

[17] Szekely, op. cit., p. 21.

[18] Wilson Peres, "Japanese Joint Ventures with the Mexican State: The Limits of Forced Cooperation," in Gabriel Szekely (ed.), Manufacturing Across Borders and Oceans: Japan, the United States, and Mexico (Monograph Series, 36) (La Jolla, California: Center for U.S.-Mexican Studies, University of California, San Diego, 1991), p. 77.

[19] Telephone interview with Szekely, op. cit.

[20] Michael Hart, A North American Free Trade Agreement: The Strategic Implications for Canada (Halifax, Nova Scotia: Institute for Research on Public Policy, 1990), p. 105.

The Canadian automotive industry is expected to push for a 60 percent North American content provision as well as some other changes in the automotive rules included in the U.S.-Canada FTA. Other Canadian manufacturers as well as labor groups are likely to share the concerns voiced in the United States and to seek tougher rules of origin for NAFTA.

The Negotiations To Date

At their June meeting USTR Hills and her Canadian and Mexican counterparts agreed to negotiate in six broad areas; since then the trade ministers and the negotiating groups have met on a number of occasions. While the talks so far have been taken up with procedural tasks, the first formal exchange of negotiating positions occurred in mid-September when the three chief negotiators met to present tariff offers and nontariff barrier requests; their next meeting is scheduled for late October.

The three countries' NAFTA negotiators also have agreed that the major criterion for determining eligibility for duty-free benefits under the pact would be that goods coming from third countries undergo a "substantial transformation" in the region. In a late August speech Mexico's secretary of commerce and industrial development said that to guarantee substantial transformation officials had opted to apply the "tariff shift" or "tariff jump" criteria, which grants duty-free status to finished goods incorporating materials imported from third countries if the customs category under which the products leave the country is different from the categories through which incorporated parts and other inputs entered the region. The regional content test would be used as an additional factor in determining origin only in certain cases; it is likely, for example, that a percentage value-based approach will be retained for cars and trucks. This provision mandates minimum North American material and processing costs that must be represented in a final product's costs.

A number of industries prefer specific approaches to determining whether a product qualifies for duty-free status; different sourcing patterns and product lines can make certain rules more burdensome or costly to various industries. Additionally, observers note that while most U.S. industries seek strong rules of origin for NAFTA, American firms do not want to make the provisions so tough that the European Community likewise would be encouraged to enact stiffer domestic control requirements.

Trade analysts suggest that NAFTA negotiators are likely to include provisions beyond tough rules of origin to ensure that the primary benefits of the agreement accrue to the three signatories. The February ITC study noted, for example, that there is some question over whether Mexico's investment restrictions and performance requirements would apply to third-country manufacturers with U.S. operations. Observers expect the U.S. production subsidiaries of Japanese-owned companies, like their American counterparts, to expand their operations into Mexico when NAFTA goes into effect. The question of what constitutes an "American" company is likely to be scrutinized carefully in this context.

NAFTA signatories, while seeking to remove restrictive regulations on trade among themselves, will maintain their individual tariffs on third-country imports rather than adopting a common tariff for nonparticipants. Negotiators stress that the agreement will be consistent with GATT and that it will not erect new barriers to nonparticipants. NAFTA will put third countries at a disadvantage largely by excluding them from the preferred relationship its members will share.

The View From Japan

Significantly, not only is Japan this country's second-largest trading partner (see Table 1) but it also holds the number-two position in both Canada's and Mexico's trade. The flip side of the coin is entirely different. The United States long has been Japan's dominant market and major supplier; Canada and Mexico show up far down the list of Japan's trading partners (see Table 2).

Table 1: U.S. Trade with Major Trading Partners, 1986-90*

(in millions of dollars; exports f.a.s., imports Customs)

	1986	1987	1988	1989	1990
Exports					
Canada (1)	$55,512	$59,814	$71,622	$78,809	$83,674
Japan (2)	26,882	28,249	37,725	44,494	48,580
Mexico (3)	12,392	14,582	20,628	24,982	28,279
Total Exports	227,159	254,122	322,426	363,812	393,592
Imports					
Canada (1)	68,253	71,085	81,398	87,953	91,380
Japan (2)	81,911	84,575	89,519	93,553	89,684
Mexico (3)	17,302	20,271	23,260	27,162	30,157
Total Imports	365,438	406,241	440,952	473,211	495,311

*Rank based on 1990 flows.

Source: Department of Commerce

Moreover, while Japan frequently is portrayed as seeking investment opportunities close to home, the amount of Japanese capital directed to Latin America (see Table 3) has rivaled funds channeled to Asia at various times in recent years. (To a large extent, however, the Latin American figures reflect the registration of vessels by Japanese shipping companies in Panama and the operations of financial firms in the region's tax havens.) Japan's cumulative direct investment in Mexico has grown rapidly, jumping from $776.6 million in 1982 to an estimated $1.5 billion in 1990, according to Mexican statistics. During that period Japanese direct investment in Mexico was topped only by the inflow from the United States, West Germany and the United Kingdom (see Table 4). In general, Japanese investment in Latin America is weighted heavily toward the nonmanufacturing sector, with a cumulative $34.1 billion invested there as of March 31, 1991 compared to $6.3 billion in the manufacturing sector. Mexico has been an exception to this trend, largely because of recent Japanese investments in maquiladora plants (see Table 5).

Table 2: Japan's Trade with NAFTA Participants, 1986-90*

(in millions of dollars; exports f.o.b., imports c.i.f.)

		1986	1987	1988	1989	1990
Exports						
United States	(1)	$80,456	$83,580	$89,634	$93,189	$90,322
Canada	(10)	5,526	5,611	6,424	6,807	6,727
Mexico	(23)	1,032	1,389	1,772	1,908	2,271
Total Exports		209,151	229,221	264,917	275,175	286,948
Imports						
United States	(1)	29,054	31,491	42,037	48,246	52,369
Canada	(10)	4,895	6,073	8,308	8,645	8,392
Mexico	(26)	1,439	1,625	1,591	1,730	1,931
Total Imports		126,408	149,515	187,354	210,847	234,799

*Rank based on 1990 flows.

Source: Ministry of Finance

Table 3: Japan's Foreign Direct Investment by Region, FY 1986-FY 1990

(in millions of dollars; notification basis)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	Cumulative March 1991
North America	$10,441	$15,357	$22,328	$33,902	$27,192	$136,185
Asia	2,327	4,868	5,569	8,238	7,054	47,519
Latin America*	4,737	4,816	6,428	5,238	3,628	40,483
Of which:						
Mexico	226	28	87	36	168	1,874
Total Investment	22,320	33,364	47,022	67,540	56,911	310,808

*Including Caribbean and other regional territories.

Source: Ministry of Finance

The Japanese government also has shown growing interest in Mexico. In September 1989 Prime Minister Toshiki Kaifu announced a $1.4 billion debt-relief package for Mexico. This was augmented by Y122.8 billion ($909.6 million at Y135=$1.00) in loans promised President Salinas when he visited Tokyo in June 1990 (see JEI Report No. 27B, July 13, 1990). Tokyo also has a stake in the debt-restructuring plan Mexico City reached with foreign bank representatives in February 1990 (see JEI Report No. 6B, February 9, 1990). Moreover,

Table 4: Cumulative Foreign Direct Investment in Mexico, 1986-90 by Country of Origin, 1986-1990

(in millions of dollars)

	1986	1987	1988	1989	1990*
United States	$11,046.6	$13,716.2	$14,957.8	$16,771.7	$19,079.7
West Germany	1,399.4	1,446.3	1,583.0	1,667.7	1,955.9
United Kingdom	556.2	987.1	1,754.7	1,799.4	1,913.8
Japan	1,037.5	1,170.3	1,319.1	1,334.8	1,455.6
Switzerland	823.0	918.2	1,004.5	1,198.9	1,346.9
France	564.9	696.1	748.5	765.0	946.0
Spain	477.3	603.1	637.2	681.2	692.0
Canada	270.3	289.6	323.5	360.9	417.0
Sweden	260.5	297.2	329.7	336.6	349.9
Italy	38.5	41.3	41.3	47.9	52.5
Other Countries	578.9	864.9	1,388.1	1,623.0	2,100.2
Total	17,053.1	20,930.3	24,087.4	26,587.1	30,309.5

*Preliminary.

Source: SECOFI, Direccion General de Inversion Extranjera, cited in Banco de Mexico, The Mexican Economy 1991.

Japan is a significant source of official development assistance to Mexico (see Table 6). In 1988 -- the most recent year for which comparative data are available -- Tokyo provided 27.7 percent of the total bilateral foreign aid Mexico received from major donor nations; 33.5 percent came from the United States, Mexico's largest source of foreign aid.

Despite Tokyo's willingness to help Mexico Japanese businesses continue to have some reservations about investing there. Using surveys conducted by Keidanren (Japan Federation of Economic Organizations) and the Japanese Chamber of Commerce and Industry in Mexico, Toru Yanagihara of Hosei University concluded that Japanese companies are encouraged by recent improvements in Mexico's macroeconomic environment. He added, however, that questions remain about the country's macroeconomic stability, Mexico City's ability to implement proposed economic reforms plus policy sustainability and stability. Inadequate infrastructure and labor frustrations also pose problems for future Japanese investment.[21]

Conclusion of the NAFTA agreement undoubtedly would be seen as providing additional incentives for firms located outside the region to invest in Mexico. Yet it is difficult to generalize about possible Japanese business reactions when NAFTA itself is still in the drafting stage. Many companies are watching

[21] Toru Yanagihara, "Japanese Perspectives on Expanding Trade and Investment in Mexico," in Opportunities for Trilateral Cooperation: Mexico, the United States, and Japan (Report from Conference on Trade and Investment Prospects with Mexico held in San Diego, California, January 9-11, 1991, sponsored by The Citizens Network for Foreign Affairs), pp. 45-48.

Table 5: Japan's Cumulative Foreign Direct Investment in Mexico by Industry, March 1981 and March 1990

(in millions of dollars; notification basis)

Industry	Cumulative March 1981 Value	Cumulative March 1981 Share	Cumulative March 1990 Value	Cumulative March 1990 Share
Manufacturing	$275	33.6%	$1,001	58.6%
Food Products	15	1.8	41	2.4
Textiles	4	0.5	8	0.5
Chemicals	38	4.6	48	2.8
Metals	47	5.7	117	6.9
Nonelectric Machinery	18	2.2	44	2.6
Electric Machinery	17	2.1	38	2.2
Transportation Equipment	132	16.1	699	40.9
Other	5	0.6	6	0.4
Commerce and Services	32	4.1	191	11.2
Resource Development	510	62.3	514	30.1
Mining	500	61.1	502	29.4
Agriculture and Forestry	2	0.2	4	0.2
Fisheries	8	1.0	8	0.5
Other	1	0.1	1	0.5
Total	818	100.0	1,707	100.0

Source: Export-Import Bank of Japan, cited in Gabriel Szekely, Manufacturing Across Borders and Oceans: Japan, the United States, and Mexico (Monograph Series, 36) (La Jolla, California: Center for U.S.-Mexican Studies, University of California, San Diego, 1991), p. 117. Used with permission.

the evolution of the agreement carefully, some with concern. The response of individual foreign firms, regardless of their home base, depends greatly on their size, their existing presence in the North American market and whether they currently have operations in Mexico.

Japanese firms with facilities in Mexico might be pressed to change supplier arrangements; some Japanese-owned Mexican manufacturing operations reportedly have started shifting component sourcing to that country in preparation for the stricter regional content rules anticipated. Yet the rules of origin under NAFTA are expected to vary for certain products, making it tricky to anticipate trends at this point.

Japanese automotive manufacturers reportedly are not troubled by the proposed pact because they already have a North American production base and have targeted domestic content figures above anything that might be included in the NAFTA agreement. Some analysts expect Japanese industrial and consumer electronics manufacturers in particular to increase their investments in Mexico; financial services firms also rank high on their lists. Others dispute the

Table 6: Japan's Official Development Assistance to Mexico, 1985-89

(in millions of dollars; net disbursement basis)

	Grants			
	Grant Aid	Technical Cooperation	Loans	Total
1985	$1.6	$9.0	$8.9	$19.5
1986	---	10.9	69.9	80.8
1987	0.3	17.1	17.6	34.9
1988	1.3	16.7	20.9	38.8
1989	4.5	16.6	3.9	25.0

Source: Ministry of Foreign Affairs

latter prediction, noting Japanese financial institutions' extreme caution and Mexico City's expected reluctance to remove remaining restrictions on foreign investment in its banking sector. Japanese-owned companies also are likely to factor in an additional risk concerning investment in Mexico: too much, too soon may inflame congressional protectionist passions, already hot about Japanese investment in this country.

An Asian Trade Bloc?

Already concerned about the apparent trend toward regional trade blocs, some Japanese government and business leaders are particularly worried about the creation of a North American free trade area. Any arrangement fostering closer ties between the United States and its number-one and number-three trading partners could present risks for number-two, it is feared. A number of analysts question whether this concern about a North American fortress will drive Japan to pursue an Asian trade bloc.

Although Japanese observers emphasize that Tokyo's cool response to the East Asian Economic Group proposed by Malaysia last year reflects its lack of enthusiasm for this type of grouping, some analysts contend that Japan will face increasing pressure to join such an alliance (see JEI Report No. 12B, March 29, 1991). In fact, Japan has been moderating somewhat its views on the subject. In early October the economic ministers of the Association of Southeast Asian Nations -- which groups Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand -- gave their support to Malaysia's proposal, which has been scaled down from the original concept of a trade bloc to a consultative forum. Tokyo, which indicated that it would wait for Asean to reach a consensus on EAEG before committing to the proposal, reportedly responded to the Asean action with qualified support for the direction the discussions were taking.

Although a number of East Asian nations were unconvinced that the EAEG as originally conceived was an answer to trading blocs, many are anxious about how NAFTA will affect their economies. Some economies in the region fear that Japanese and American investors will move production from Asia to Mexico and that their exports will be displaced by goods produced in Mexico. Predictions vary on how severe the trade diversion might be, with some saying it will be minimal and others foreseeing significant shifts in some industries.[22]

Yet Asean, wary of cutting itself off from the United States and Europe, has been cautious about jumping into an Asian bloc, notes Tony Albrecht, an adviser to the U.S.-Asean Council.[23] Japan has invested heavily in Southeast Asia and will continue to put money in the region because of the favorable investment environment and the large market Asean offers, Mr. Albrecht predicts. Japanese manufacturers are likely to locate a production facility in Mexico rather than at an Asean site only if the plant is intended to serve the North American market, he adds.

Outlook

The North American Free Trade Agreement is far from being concluded and even further from implementation. Although Bush administration officials initially indicated the agreement could be completed by the end of this year or early 1992, trade ministers from the three nations recently conceded that the talks may go on longer than anticipated. Some in Congress and the private sector have urged the executive branch not to rush into a pact; they fear that many questions regarding the impact of NAFTA will remain unanswered or even unposed in the short run.

The timing of a NAFTA agreement has important implications. Although some critical issues could be resolved if the Uruguay Round is successfully concluded, the failure of those talks could intensify pressures for a North American free trade agreement. Some trade analysts predict that the collapse of multilateral efforts to liberalize international trade could lead to a more protectionist North American arrangement. They have an additional worry. If a draft agreement is presented to Congress early next year, election-year politics could entangle NAFTA's chances of winning Congress' approval.

Even if all three nations approve an agreement, its provisions will need to be phased in gradually to account for Mexico's lower level of economic development. The pact may not be fully implemented for another 15 years. As the agreement takes shape, political and business leaders both in North America and outside the region will be weighing the risks and the opportunities offered by NAFTA as well as its potential impact on the interplay between their economies.

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[22] For a discussion of the impact of a FTA with Mexico on trade with other countries see USITC, op. cit., p. II-6.

[23] Telephone interview with Tony Albrecht, adviser to the U.S.-Asean Council, Washington, D.C., September 6, 1991.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

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Japan's Trade Surplus Jumps

Like an ebbing tide a slowing economy often reveals much about underlying conditions. Japan's customs-clearance trade statistics for the July-September quarter are a good example. In dollar terms the nation's trade surplus jumped 41.7 percent over a year earlier (see Tables). The latest figures represented both the third straight quarter that the gap between exports and imports had widened on a year-to-year basis and the largest third-quarter imbalance since 1986. The rising trade surplus has made more visible some previously submerged explanations of the now-ended import surge -- such as factors that provided only a temporary boost to purchases from abroad.

As in the April-June period, the movement in the dollar-denominated surplus in the third quarter exaggerated the increase in the imbalance more than if it had been measured on a volume basis. Although exports jumped 9.5 percent in dollar terms, the increase came to only 2.9 percent when measured by volume. In contrast, dollar-denominated imports rose just 0.6 percent but increased in volume 2.3 percent. Hence, adjusted for price and exchange-rate changes, the increase in Japan's July-September surplus was far less than when measured in dollars or yen.

Unlike the previous quarter, however, the surplus increased even in volume terms over the year-earlier quarter, as shown by the fact that export growth exceeded import growth. This point is significant in light of the evidence that many of Japan's major trading partners, including the largest -- the United States, probably continued in the throes of a recession. Officially at least, the Japanese expansion continues, albeit at a slower pace than in the past. Other factors equal, more rapid economic growth at home than in export markets would lead one to expect that the volume of Japanese imports would grow faster than that of exports, even allowing for the fact that some export markets continue to be healthy. What, then, explains the discrepancy?

A typical explanation, the value of the yen on international currency markets, probably is not a major factor in the movement of the price-adjusted external imbalance during the July-September period. Through most of the past year the Japanese currency has edged upward, standing nearly 8 percent higher against the dollar in the third quarter than a year earlier. If anything, the yen's appreciation would lead one to expect import growth to exceed export growth in volume terms, the reverse of what happened.

In this case the most important explanations appear to be not only the macroeconomic condition of Japan vis-a-vis its trading partners but long-run factors as well. First, the trade figures hint that the Japanese economy is in worse shape than government pronouncements recognize. The year-to-year increases in import volume of 0.6 percent and 2.3 percent over the past two quarters are the smallest since the days of the strong dollar in 1985 and far lower than during Japan's most recent officially recognized economic downturn, which ended in late 1986. Yoshio Suzuki of Nomura Research Institute explains Japan's rising surplus as being consistent with Japan and its trading partners being on different points in the business cycle; Japanese demand is still slowing, while that elsewhere is recovering. Hence, he sees the run-up in Japan's trade surplus as temporary.

Second, some of the factors once believed to be long run in nature now appear to have boosted imports only temporarily in the late 1980s. For example, a portion of the surge in imports after the yen started to appreciate in the fall of 1985 apparently resulted partly from the inflated incomes that accompanied financial speculation and Japan's "bubble" economy. This explanation contrasts with thinking at the time that the increment represented a structural change. As the stock market's value has stagnated and real estate speculators have experienced financial difficulty, Japan's high rollers have lost their appetite for expensive imported cars and other pricey foreign goods. This argument suggests that the current value of the trade surplus might be closer to a sustainable level than it was a year ago.

For Tokyo the latest figures have created a major headache. The reverse trend throughout 1991 has weakened, if not shattered, a long-standing argument -- that Japan's external imbalance, while still large by most measures, is falling. Furthermore, the chorus of complaints is likely to be heard in several languages. In the last two quarters Japan had surpluses of $13.4 billion with the European Community, $16.6 billion with Asian countries and $17.5 billion with the United States. Although the U.S. figure represents a 4.5 percent drop

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$209,151	19.1%	$126,408	-2.4%	$82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1989	275,175	3.9	210,847	12.5	64,328
1990	286,948	4.3	234,799	11.4	52,149
1989: I	68,227	13.2	51,142	14.9	17,085
II	67,602	3.7	51,292	8.5	16,310
III	69,595	3.6	53,048	12.3	16,547
IV	69,751	-3.5	55,364	14.6	14,387
1990: I	66,705	-2.2	54,383	6.3	12,322
II	67,232	-0.5	53,954	5.2	13,278
III	72,189	3.7	56,547	6.6	15,642
IV	80,822	15.9	69,914	26.3	10,908
1991: I	76,384	14.5	61,820	13.7	14,564
II	74,003	10.1	56,253	4.3	17,750
III (p)	79,077	9.5	56,906	0.6	22,171

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y35,290	-15.9%	Y21,551	-30.7%	Y13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1989	37,823	11.4	28,979	20.7	8,844
1990	41,457	9.6	33,855	16.8	7,602
1989: I	8,705	12.9	6,516	14.6	2,189
II	9,222	13.0	6,997	18.2	2,225
III	9,911	11.0	7,547	20.2	2,363
IV	9,985	9.3	7,919	29.4	2,067
1990: I	9,766	12.2	7,941	21.9	1,825
II	10,449	13.3	8,392	19.9	2,057
III	10,651	7.5	8,364	10.8	2,287
IV	10,592	6.1	9,159	15.7	1,433
1991: I	10,190	4.3	8,251	3.9	1,939
II	10,226	-2.1	7,771	-7.4	2,456
III (p)	10,855	1.9	7,820	-6.5	3,035

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	$80,456	23.3%	$29,054	12.6%	$51,401
1987	83,580	3.9	31,491	8.4	52,090
1988	89,634	7.2	42,037	33.5	47,597
1989	93,189	4.0	48,246	14.8	44,943
1990	90,322	-3.1	52,369	8.5	37,954
1989: I	22,726	14.4	11,599	15.0	11,127
II	22,997	6.4	12,064	15.4	10,933
III	24,117	4.6	12,462	16.8	11,655
IV	23,347	-7.0	12,120	12.0	11,227
1990: I	21,661	-4.7	12,753	9.9	8,908
II	20,938	-9.0	12,861	6.6	8,077
III	22,933	-4.9	12,729	2.1	10,204
IV	24,790	6.2	14,025	15.7	10,765
1991: I	22,324	3.1	13,247	3.9	9,077
II	20,309	-3.0	13,446	4.5	6,863
III (p)	23,700	3.3	13,102	2.9	10,598

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1986	Y13,564	-13.0%	Y4,918	-20.9%	Y8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988	11,487	-5.4	5,388	17.6	6,099
1989	12,816	11.6	6,632	23.1	6,184
1990	13,057	1.9	7,586	14.4	5,471
1989: I	2,899	14.1	1,478	14.6	1,421
II	3,139	16.0	1,648	25.9	1,491
III	3,436	12.2	1,773	25.0	1,663
IV	3,342	5.2	1,733	26.4	1,609
1990: I	3,171	9.4	1,862	26.0	1,309
II	3,254	3.7	2,000	21.4	1,254
III	3,384	-1.5	1,885	6.3	1,498
IV	3,249	-2.8	1,838	6.1	1,411
1991: I	2,978	-6.1	1,767	-5.1	1,211
II	2,807	-13.7	1,857	-7.2	950
III (p)	3,253	-3.9	1,801	-4.5	1,452

compared to a year earlier, the other figures are higher than in the comparable period of 1990. In the July-September quarter even the surplus with this country rose 3.9 percent. These numbers have ignited a debate in Japan about countermeasures. Alternatives include benign neglect on the grounds that the surge is temporary or, possibly, still more appreciation of the yen or measures to stimulate the economy, such as lower interest rates.

Douglas Ostrom

Tokyo Acts On Financial Scandals As Washington Watches

Although the stream of revelations concerning financial misconduct by Japanese securities firms and banks seems to have ceased for the moment, the Ministry of Finance continues to mete out penalties and examine proposed reforms of Japan's financial regulations and structures. The ministry's standard step-by-step approach for action, however, risks alienating both small Japanese investors and the U.S. government. Many of MOF's actions have been criticized at home and abroad as cosmetic, just as many of the issues raised by the financial scandals have been termed critical and fundamental.

After a summer in which repeated disclosures showed widespread pre-FY 1990 client compensation for stock trading losses by Japanese securities brokers, the country's four largest brokerage houses acknowledged in September that they had defied MOF's administrative guidance after December 1989 by compensating clients for stock trading losses to the tune of Y43.6 billion ($323 million at Y135=$1.00). As penance, the Big Four -- Nomura Securities Co., Ltd., Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd. and Yamaichi Securities Co., Ltd. -- accepted the ministry's "suggestion" that they voluntarily withdraw for one month from the primary market for government bonds (see JEI Report No. 37B, October 4, 1991). While most Japanese observers agreed that this embarrassed the four brokerages, they also agreed that the financial pain inflicted on the firms would be minimal. (According to data on the latest bond offering, the government, not the brokers, appears to be bearing the brunt of the suffering; more than half of the issue was unsubscribed.)

Critics also charged that MOF's handling of the situation underscored the cozy, behind-closed-doors relationship between the ministry and the securities industry. The punishment, for example, was decided on by MOF officials without public input.

Stung by these comments MOF decided to investigate in a more open manner charges that Nomura Securities had manipulated the price of a railroad stock. During an unprecedented public questioning by a Finance official Nomura president Hideo Sakamaki admitted October 7 that Nomura employees did engage in "excessive promotion" of Tokyu Corp. shares in 1989. While MOF officials stress that this admission is not proof that Nomura manipulated the stock's price, such promotion is, itself, a violation of MOF's administrative rule that bans activities that interfere with the fair formation of stock prices.

To quell the controversy over the compensation and the manipulation revelations, MOF hit Nomura and the other Big Four companies with tougher sanctions than those imposed this summer (see JEI Report No. 27B, July 19, 1991). The new punishments, effective October 15, included: